91-530

No. _____

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IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1991

JAMES C. PLEDGER, COMMISSIONER
OF REVENUES, *Petitioner*

V.

ILLINOIS TOOL WORKS, INC., *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ARKANSAS

PETITION FOR A WRIT OF CERTIORARI

JOYCE KINKEAD, AR Bar No. 83100
Attorney, Revenue Legal Counsel
Arkansas Department of
Finance and Administration
Seventh & Wolfe Streets
P.O. Box 1272-L
Little Rock, Arkansas 72203
(501) 682-7030
Counsel of Record

ARKANSAS LEGISLATIVE DIGEST, INC.

QUESTIONS PRESENTED

I.

WHETHER DUE PROCESS REQUIRES A SINGLE CORPORATE ENTITY TO MEET THE REQUIREMENT OF A UNITARY RELATIONSHIP BETWEEN THE INCOME-PAYOR CORPORATION AND INCOME-RECIPIENT CORPORATION BEFORE INCOME CAN BE APPORTIONED.

II.

WHETHER INTANGIBLE INCOME, SUCH AS CAPITAL GAINS, CAN BE APPORTIONED IF THE INVESTMENT AND ACQUISITION ACTIVITIES OF THE CORPORATION RECEIVING THE INCOME CONSTITUTE AN INTEGRAL PART OF ITS REGULAR TRADE OR BUSINESS.

LIST OF PARTIES

The parties to the proceedings below were the petitioner James C. Pledger, Commissioner of Revenues, Department of Finance and Administration, State of Arkansas and the respondent Illinois Tool Works.

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No. _____

JAMES C. PLEDGER, COMMISSIONER
OF REVENUES, *Petitioner*

V.

ILLINOIS TOOL WORKS, INC., *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ARKANSAS

The petitioner James C. Pledger, Commissioner of Revenues, Department of Finance and Administration, State of Arkansas, respectfully prays that a writ of certiorari issue to review the opinion of the Supreme Court of Arkansas entered in the above-entitled proceeding on June 24, 1991.

OPINIONS BELOW

The opinion of the Supreme Court of Arkansas is reported at 306 Ark. 134, ___ S.W.2d ___ (1991), and is reprinted in the appendix hereto, App. A-1—A-14, *infra*. The Judgment and Memorandum Opinion of the Chancery Court of Pulaski County, Arkansas, Second Division, are not reported. These are reprinted in the appendix hereto, App. B-1—B-22, *infra*.

JURISDICTION

The Opinion of the Supreme Court of Arkansas (App. A-1—A-14) was delivered on June 24, 1991. The jurisdiction of this Court to review the opinion of the Supreme Court of Arkansas is invoked pursuant to 28 U.S.C. § 1257(a). This petition is timely filed under 28 U.S.C. § 2101.

CONSTITUTIONAL PROVISION INVOLVED

U.S. Const. Amend. XIV, § 1 provides, in pertinent part:

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law.

STATUTORY PROVISION INVOLVED

Act 413 § 1 of 1961, codified at Ark. Code Ann. § 26-51-701 states, in pertinent part:

> (a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations; . . .
>
> (e) "Nonbusiness income" means all income other than business income; . . .

REGULATION INVOLVED

Regulation 1977-4 is included herein at App. C-1—C-9.

POLICY STATEMENT INVOLVED

Revenue Policy Statement 1984-2 is set forth in its entirety at App. D-1—D-2.

STATEMENT OF THE CASE

1. Illinois Tool Works Made Significant Investments and Excluded Capital Gains From Income Apportionable to Arkansas

Illinois Tool Works, Inc. (Illinois Tool Works) is a corporation organized and existing under the laws of the State of Delaware, with its principal office and commercial domicile in Chicago, Illinois. Although Illinois Tool Works began as a machine tool manufacturer, it has expanded its business operations so that by the years before this Court, it was engaged in a broad spectrum of business activities, with seventeen (17) separate operating divisions within the United States and a number of similar businesses in foreign countries. The 1983 annual report indicated that Illinois Tool Works had 29 principal domestic operations, 15 international operations, six (6) affiliates (one operating affiliate which is relevant here — Nifco, Inc.) in 16 countries around the world. (R. 416) In 1966, Illinois Tool Works opened a division, which manufactures drills and end mills used in the automotive and aviation industry, in Pine Bluff, Arkansas. (R. 198-199) The Hi-Cone Division leased equipment to beverage manufacturers in Arkansas.

In addition, Illinois Tool Works managed a significant portfolio of investments in related subsidiaries and affiliates.

> Internally, we like to say of this dynamic process that we are in the business of creating businesses. (R. 385)

Illinois Tool Works made its first major acquisition of corporate stock in 1976. (R. 194) The number of annual acquisitions increased significantly in 1981. The acquisitions contributed to its growth during the next ten to twelve years

(R. 194), and, in 1981, acquisitions accounted for one-half of its growth in revenue. (R. 347) The excess cash posture changed with the aggressive acquisition positions. (R. 199, 270) Prior to that time, most of the growth had been internal, but throughout the 1980s growth was both internal and from the acquisition program. (R. 270)

> The decline in working capital and cash and securities during 1981 was the result primarily of a number of acquisitions and investments. (R. 362)

The practice of Illinois Tool Works has been to use its surplus in "above-average, long-term situations with the potential for capital appreciation." (R. 347)

Illinois Tool Works sold all of its Nisco and Computer Products stock and a portion of its Nifco stock during 1981 through 1983. Illinois Tool Works has indicated that it was not involved, other than as an investor, in these corporations. It has further indicated that there were:

- no transfer of raw materials or semi-manufactured products
- no integration as far as the manufacturing concepts were concerned
- no common officers or employees
- no common administrative services provided such as accounting, legal training, etc.
- no general standards, business practices or policies imposed on affiliates
- no transfer of employees back and forth
- no loans or guarantees of loans
- no common purchasing or billing system
- no decisions made on product lines
- no training of employees

(R. 199, 215-217, 219-220)

A primary focus of Illinois Tool Works has been on the development of new products through its internal technical skills. Through the expansion of its technology, it derived royalties by licensing the technology. It also acquired related products and expertise.

Specific asset sales of Illinois Tool Works are discussed *infra*.

NIFCO, INC. (NIFCO)

Illinois Tool Works held a forty percent (40%) interest in Nifco, when it was initially formed in 1967. Japanese law prohibited Illinois Tool Works from holding a majority interest. The stock ownership percentage fluctuated, and an additional investment of $6,170,000 was made during 1980. This increased the ownership percentage to 32.1%. (R. 367)

By 1983, the interest had been reduced from 32.1% to 24%. Investors had converted debentures into common stock which diluted Illinois Tool Works' ownership percentage, and a sale of stock on the open market was necessary so Nifco could move from level two to level one on the Tokyo stock exchange. The Illinois Tool Works board of directors went along with Nifco's desire to make this move. (R. 211-212)

Since Illinois Tool Works could not legally maintain a majority interest in Nifco, involvement in its initial formation was important. Through this early pursuit it was able to maximize its product expertise through technology or license agreements. As Nifco became more successful, Illinois Tool Works' interest became more valuable. (R. 246) It held three (3) positions on the Nifco Board of Directors.

As a result of these technology and license agreements,

Nifco manufactured various fastener products similar to those produced by Illinois Tool Works, and the royalty income generated therefrom was reported as apportionable income to the State of Arkansas. Nifco was the principal operating affiliate of Illinois Tool Works.

The Hi-Cone Division of Illinois Tool Works, which had a small amount of equipment on lease to beverage manufacturers in Arkansas, entered into a joint venture with Nifco, while Nifco was an affiliate of Illinois Tool Works. Through the joint venture, Hi-Cone beverage carrier and applicating machinery were sold and leased in Japan, Hong Kong, the Philippines, Korea and Taiwan. (R. 423) The 1983 Form 10-K filed by Illinois Tool Works with the Securities and Exchange Commission showed the following:

> Nif-Cone Leasing Ltd.
> Hong Kong
> 40% owned by Illinois Tool Works, Inc.
> 60% owned by Nifco, Inc.

A joint venture was also formed between Nifco and Illinois Tool Works, in the United States, to supply automotive parts to Japanese automakers at their locations in the United States.

In 1983, the Illinois Tool Works board of directors agreed to sell a portion of its stock in Nifco so Nifco could enter level one of the Tokyo Stock Exchange. (R. 212-213) Capital gains of $11,044,546 were realized. In 1984, individuals representing Illinois Tool Works on the Nifco board of directors resigned. Illinois Tool Works evidenced its desire to retain a degree of control over the activities of Nifco. (App. F-1—F-2, *infra*)

NISCO, INC. (NISCO)

Nisco, Inc. (NISCO) is a Japanese Company formed in 1964. (R. 196-197, 244-245) By purchasing a forty-nine percent (49%) interest, Illinois Tool Works had a hand in the initial formation of Nisco.

Forty-nine percent (49%) was the largest percentage of foreign stock ownership sanctioned by the Japanese government. By becoming involved at the inception, Illinois Tool Works, through its license agreement, could continue to use its product technology to produce royalty income. The royalty income was included in apportionable income to the State of Arkansas.

Nisco produced threaded fasteners, products similar to those of Illinois Tool Works, since Illinois Tool Works had licensed it for both "know-how" and "direct" technology. (R. 203-204) All licensing agreements were required to meet the approval of the Japanese government.

Although Illinois Tool Works had three (3) members on Nisco's eleven or twelve member board of directors, the directors did not attend every meeting. Illinois Tool Works reviewed the overall direction of Nisco, it was not involved in the day-to-day type management decisions. (R. 206) It was also involved as a licensor of technology.

As a result of differences with the Nisco management as to the direction Nisco was going, an installment agreement to sell its stock was reached in 1978 with the Japanese shareholders. The treasurer's office was not directly involved in this sale. (R. 204-205) (Nisco was not traded on the Tokyo Stock Exchange but was privately owned.)

By 1981, Illinois Tool Works owned less than ten percent (10%) of the outstanding stock of Nisco. The remaining interest was sold in 1981, and a capital gain of $2,952,615 was realized. The proceeds from the sale of the Nisco stock were deposited into the general corporate cash account. (R. 249-250)

COMPUTER PRODUCTS, INC. (Computer Products)

Three (3) major differences become obvious when Computer Products, Inc. is compared with Nisco and Nifco. (1) Computer Products, Inc. is an American corporation. (2) Illinois Tool Works did not enter into a technology or licensing agreement with Computer Products, and (3) the products of Computer Products, Inc. are totally unrelated to the products of Illinois Tool Works.

The rationale behind the purchase of the stock of Computer Products by Illinois Tool Works, in the late 1970s and subsequent years, was more like a business decision than an investment decision. (R. 247) Illinois Tool Works was interested in the technology of Computer Products, and it felt that it could learn about that technology by obtaining a small equity position. (R. 197, 247) From this knowledge of technology, Illinois Tool Works could ascertain whether it would have any further interest in the future.

Computer Products, Inc. was shown as an investment affiliate on the annual reports of Illinois Tool Works. In 1981, it issued additional common stock, which diluted the percentage ownership of Illinois Tool Works. In December, 1981, additional shares were purchased at a cost of $3,055,000, which brought the equity percentage back to twenty-three percent (23%). Illinois Tool Works was entitled to two (2) positions on the board of directors.

The stock was sold in 1983, and a capital gain of $4,947,649 was realized.

PREFERRED STOCK

Illinois Tool Works had a number of purchases and sales of preferred stock during the years 1981 through 1983.[1]

[1]

	1981			
Company	No. Shs. Purch.	Purch. Price	No. Shs. Sold	Amount Realized
Chase Bank	7,500	$ 295,312	—	—
P.S.E.G.	4,000	241,760	—	—

	1982			
Company	No. Shs. Purch.	Purch. Price	No. Shs. Sold	Amount Realized
Chase Bank	—	—	7,500	$ 299,990
P.S.E.G.	—	—	4,000	244,500
Chemical N.Y.	10,000	502,500	—	—
First Chicago	5,000	250,000	—	—
Bank America	20,000	1,000,000	—	—
Manufacturers Hanover Bank	5,000	276,250	—	—
Irving Trust	10,000	500,000	—	—
Carolina Power & Light	7,000	462,000	—	—
NW Central Pipeline	5,000	250,000	—	—

	1983			
Company	No. Shs. Purch.	Purch. Price	No. Shs. Sold	Amount Realized
Chemical N.Y.	—	—	10,000	$ 552,500
First Chicago	—	—	5,000	280,625
Bank America	—	—	20,000	1,050,000
Manufacturers Hanover Bank	—	—	5,000	280,625
Irving Trust	—	—	10,000	522,500
Carolina Power & Light	—	—	7,000	435,750
NW Central Pipeline	—	—	5,000	251,250
Mohawk Power	10,000	250,000	10,000	240,000
Bank of NY	10,000	500,000	10,000	445,000
Citicorp	10,000	1,000,000	10,000	847,500
Marine Midland	10,000	500,000	10,000	502,500

Petitioner conceded in the administrative hearing that the sales of preferred stock were "nonbusiness income".

COMMERCIAL PAPER

Commercial paper, a fairly short-term investment, was reported as income and apportioned to the State of Arkansas.

UNDEVELOPED REAL PROPERTY (LAND)

As a general investment policy, Illinois Tool Works would not be interested in land. (R. 262) However, in several instances it purchased excess land when buying existing facilities or if planning to build a facility. (R. 261) There were also several purchases of significant amounts of undeveloped land. (R. 228)

In the mid-1960s through 1971, Illinois Tool Works purchased twenty to twenty-five acres which is immediately south across an expressway from its corporate office along the Kennedy Expressway. (R. 225-229) Although the land was acquired as property upon which to build its own corporate office building (R. 260), it was never used at all. (R. 228) Instead, it was leased to a farmer who raised corn and other crops.

The land was classified as "investment land" in the annual reports. This category was used to segregate the cost of land not associated with operating facilities. (R. 225-229), and it was not included in the property factor of the three-factor formula used in apportionment of income. Due to the nature of undeveloped real property, no one devoted any time to the management of the land.

The corporate office made a decision to sell the land in

installments. The capital gains derived from its sale in 1982 and 1983 are respectively — $355,300 and $1,167,673. This issue was conceded by Petitioner in an appeal to the Supreme Court of Arkansas.

UNITED STATES TREASURY NOTES

From the late 1970s through 1981, the treasurer's office purchased United States Treasury Notes, usually at a discount, from ten to twenty times per year. (R. 224, 254) These notes were normally held to maturity, which ranged from one (1) to four (4) years. (R. 256) The capital gains realized reflect the difference between the discounted purchase price and the face value received at maturity. These gains were: 1981 — $599,688; 1982 — $362,656; and 1983 — $633,750.

Income from the Pine Bluff, Arkansas division could have been used to purchase these notes, because Illinois Tool Works did not segregate its cash from or to its operating divisions. (R. 254)

FOREIGN CURRENCY TRANSACTIONS
(Hedging Contracts)

Illinois Tool Works had an unwritten policy that it did not enter into purely speculative hedges, (R. 276) and no specific fund was set aside to purchase these contracts. It did, however, enter into foreign currency transactions under two sets of circumstances.

First, a "balance sheet" form of hedging was entered into from 1975 to 1981. (R. 262-266) Illinois Tool Works had an English subsidiary, and the Financial Accounting Standards Board, in opinion No. 8, required the presentation of any losses due to change in the foreign currency rates on the

company's profit and loss statement. To alleviate or minimize this problem, which could adversely affect operations and the marketing of its stock on the New York Stock Exchange, it entered into foreign currency transactions. Working capital or excess funds were used for the purchases.

In 1981, Illinois Tool Works entered into a two-year contract on the British pound. During 1983, a $3,279,600 capital gain was realized.[2]

Although the above type of hedging terminated in 1981, Illinois Tool Works continued hedging of specific dollar or foreign currency flows. (R. 262-266) This type of hedging protected foreign dividends from losses due to currency fluctuations. No specific issues concerning this type of hedging are present here.

2. The Chancery Court held that certain investments were in corporations that were separate and discrete businesses and that assets, other than the corporate stock, were held as investments and not utilized as a part of Illinois Tool Works regular business. The Supreme Court of Arkansas affirmed the Chancellor's decision.

On its tax returns for 1981, 1982 and 1983 Illinois Tool Works treated capital gains from the sale of stock in Nifco, Nisco and Computer Products; land, treasury notes and foreign currency transactions as "nonbusiness income", and

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[2]Prior to this realization of gain, the Financial Accounting Standards Board, in opinion 52, had deleted the requirement of loss presentation on the profit and loss statement. The loss could be shown on the balance sheet as a change in the equity component. Illinois Tool Works then discontinued this type of hedging.

these capital gains were excluded from its computation of Arkansas taxable income.[3]

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[3]Illinois Tool Works also made significant investment-type expenditures in the years 1981-1983. The annual reports reflect the following:

Other Assets	1983	1982	1981	1980
Investment Land at Cost	$ -0-	$ 4,416,000	$ 4,899,000	$ 4,301,000
Operating Affiliates	-0-	19,880,000	19,839,000	19,240,000
Investment Affiliates	-0-	37,766,000	33,013,000	15,579,000
Other Investment in Affiliates	33,169,000	33,767,000	25,840,000	8,972,000
Investments	18,329,000**	-0-	-0-	-0-
Total Other Assets	33,169,000**	-0-	-0-	-0-
	$96,648,000	$95,829,000	$83,591,000	$48,092,000

**Change in classifications. Investment land was changed to investments, and one affiliate was also reclassified to investments.

Interest bearing deposits and marketable debt securities	$74,586,000	$40,357,000	$29,040,000	$68,942,000

Funds Were Provided By:	1983	1982	1981	1980	1979
Total from Operations	$73,723,000	$62,679,000	$67,364,000	$60,075,000	$41,421,000
Sale of Investments	5,154,000	-0-	-0-	-0-	-0-
Sale of Investment Land	***	483,000	-0-	377,000	1,084,000
Sale of Interest in Investment Affiliates	***	-0-	842,000	1,234,000	1,818,000
Sale of Interest in Affiliates	7,039,000	***	***	***	***
Issuance of Common Stock	2,137,000	507,000	151,000	27,000	194,000
Other Net	3,636,000	1,923,000	-0-**	-0-**	-0-**
Total Funds Provided	$91,689,000	$65,592,000	$68,357,000	$61,713,000	$62,514,000

These returns were examined, and the auditor proposed that these gains be reclassified as "business income" and

---

[3]*Continued*

**Shown under Operations					
***Reclassified Acquisition of Plastiglide Manufacturing Corporation Excluding Working Capital	-0-	-0-	19,670,000	-0-	-0-
Purchase of Additional Interest in Subsidiary and Affiliates	$14,404,000	$10,000,000	$18,520,000	$ 7,368,000	$10,621,000
Changes in Working Capital					
Increase (decrease) in current assets —					
Cash, Interest Bearing Deposits and Marketable Debt Securities	$36,931,000	$12,186,000	($41,334,000)	$ 9,225,000	$ 1,322,000

Investments in "Safe harbor" tax leases:

1981 — $8,000,000

1982 — $8,500,000

1981 Note to Annual Report

Short-Term Debt consists primarily of borrowings by certain international subsidiaries for working capital requirements.

Long-Term Debt of $5,478,000 at December 31, 1931 and $2,878,000 at December 31, 1980 consists of borrowings by certain international subsidiaries and Plastiglide Manufacturing Corporation.

1983 Note to Annual Report

During the third quarter of 1983, an investment banker was engaged to evaluate the properties [of Ricks Exploration Company] and to explore the possible sale of Ricks with a number of prospective purchasers.

subjected to the Arkansas income tax (through use of the three-factor apportionment formula). Illinois Tool Works filed a written protest, and an administrative hearing was held. The Administrative Law Judge issued a decision upholding the reclassification as "business income". A revision request was made, but the request was denied by the Commissioner of Revenues.

Illinois Tool Works timely paid the assessed income taxes and interest "under protest", and filed suit in Chancery Court. Illinois Tool Works continued to argue that U.S. Supreme Court opinions in *ASARCO, Inc.*, 458 U.S. 307, (1982) (*ASARCO*) *F. W. Woolworth Co.*, 458 U.S. 354 (1982) (*Woolworth*), and *Container Corp. of America*, 463 U.S. 159 (1983) (*Container*) required the application of the "unitary business principle" to satisfy the due process requirements of the Fourteenth Amendment of the United States Constitution, and as a condition precedent before intangible income could be apportioned to Arkansas. It further contended that the decision of the Arkansas Supreme Court in *Qualls v. Montgomery Ward*, 266 Ark. 207, 585 S.W.2d 18, 8 ALR 4 916 (1979) (*Montgomery Ward*) could not stand under *ASARCO, Woolworth* and *Container*. It also maintained that the full apportionment rationale espoused in Income Tax Regulation 1977-4 and Revenue Policy Statement 1984-2 was rejected in those Supreme Court cases.

An extensive Stipulation of Fact was entered into, and testimony was presented. Based upon the record the Chancellor determined that the capital gains were "nonbusiness income" and not subject to apportionment. The Chancellor held that Nifco, Nisco and Computer Products were "operated as discrete and separate businesses that were not operated as part of a unitary business." He agreed that the

land and treasury notes were held as investments and not utilized as an integral part of Illinois Tool Works' regular worldwide manufacturing and leasing business. The foreign currency transactions were found not to be an integral part of its regular business.

The Chancellor also determined that there was no connection between the management of assets in Chicago and the Pine Bluff or Hi-Cone Division's activities in Arkansas or Illinois Tool Works' worldwide manufacturing and leasing businesses.

An appeal of the Chancellor's decision was made to the Arkansas Supreme Court. The Arkansas Supreme Court affirmed the decision below on June 24, 1991 (App. A-1—A-14). The Court found that this Court did not intend for the "unitary business principle" to apply only to dividends and that the "unitary business principle" analysis should be applied to the facts of this case. It overruled *Montgomery Ward* and found Regulation 1984-2 (actually a policy statement not a regulation) unconstitutional.

In applying the "unitary business principle" to the capital gains from sale of the Nifco, Nisco and Computer Products stock, the Arkansas Supreme Court looked to: the percentage of stock ownership (majority versus minority interests); exercise or nonexercise of control; corporate directorships; "[t]he potential to operate a company as part of a "unitary business"; lack of common employees or officers; no administrative services provided; and payment of royalties by Nifco and Nisco for use of technology. It found that the companies were not a part of a "unitary business" but were separate and distinct businesses.

In finding that the ownership of land, Treasury Notes

and foreign currency contracts were normal or passive investments and not an integral part of the manufacturing and leasing businesses carried on at the Pine Bluff plant, the Court cited *ASARCO* for the proposition that:

> the business of a corporation requires that it earn money to continue its operations and to provide a return on its invested capital but the use of this money for the business does not fit the "unitary business principle" test.

REASONS FOR GRANTING THE PETITION

I.

THE DECISION OF THE SUPREME COURT OF ARKANSAS CONFLICTS WITH THE DECISIONS OF OTHER STATE COURTS OF LAST RESORT ON THE DUE PROCESS STANDARDS TO BE ADHERED TO IN DETERMINING THE APPORTIONABILITY OF INCOME. IT ALSO CONSIDERED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN DECIDED BY THIS COURT.

A real conflict exists among the state courts, and this spectre of never ending uncertainty has resulted primarily from the inconsistent positions taken by the state courts in applying the decisions of this Court in a series of cases dealing with the unitary business principle.

Rule 10.1(b) indicates that review by certiorari is indicated when a state court of last resort "has decided a federal question in a way that conflicts with the decision of another state court of last resort." Since 1983, when *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983) was decided, there has been considerable litigation in the state courts and, as Justice Steele Hays said so well in his dissent in this case, "very little harmony." This Court can bring "harmony" to the application of the unitary business principle by granting this Petition.

The differing results reached stem primarily from interpretations given this Court's decision in *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982) (*ASARCO*). A divergence of opinion has centered around the question of whether there is one exclusive test to be applied in

determining if income from intangible assets may be apportioned. Some state courts have held that there must be a unitary relationship between the income-payor and the income-recipient before the income can be apportioned, or stated differently, whether the income-payor is operated as a discrete and separate business and not as part of a "unitary business". Other state courts have held that such income is apportionable if the income is generated by investments used to advance the operations of the unitary business, or if either the income producing asset or activity is part of the taxpayer's unitary business.[4]

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[4]Cases holding must have unitary relationship between income-payor and income-recipient:

Corning Glass Works v. Va. Dept. of Tax, 402 S.E.2d 35 (Va. 1991)

James v. Int'l. Tel. & Tel. Corp., 654 S.W.2d 865 (Mo. 1983)

Brunner Enterprises, Inc. v. Dept. of Revenue, 452 So.2d 550 (Fla. 1984)

American Home Products Corp. v. Limbach, 49 Ohio St.3d 158, 551 N.E.2d 201, *cert. denied*, ___ U.S. ___ , 111 S.Ct. 63 (1990)

Cases holding unitary relationship between payor and payee not required:

Bendix Corp. v. Director, No. A-47, Slip Op. (N.J. Sup. Ct. July 16, 1991) (1991 N.J. LEXIS 72)

Comptroller v. Armco, Inc., 70 Md. App. 403, 521 A.2d 785 (1987)

Lone Star Steel Co. v. Dolan, 668 P.2d 916 (Colo. 1983)

M. Lowenstein Corp. v. South Carolina Tax Comm'n., 298 S.C. 93, 378 S.E.2d 272 (Ct. App. 1989)

NCR Corp. v. Comptroller, 313 Md. 118, 544 A.2d 764 (1988)

Silent Hoist & Crane Co. v. Director, 100 N.J.1, 494 A.2d 775, *cert. denied*, 474 U.S. 995 (1985)

Williams Cos. v. Director, 799 S.W.2d 602 (Mo. 1990) *cert. denied*, ___ U.S. ___ , 115 L.Ed.2d 1079 (1991)

There are also a number of cases pending nationwide.[5]

Rule 10.1(c) contains one reason that a petition for a Writ of Certiorari will be considered — when a state court . . . has decided an important question of federal law which has not been, but should be, settled by this Court . . .

The Supreme Court of Arkansas, and other state courts of last resort, have latched onto the requirement that the income-payor must be in a unitary relationship with the income-recipient before intangible income can be apportioned. An exclusive test does not exist. The Court decided *ASARCO* based upon the facts before it. That is emphasized in *Container*, 463 U.S. at 168:

A final point that needs to be made about the unitary

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[5]Pending Cases

Arkansas currently has cases, involving sixteen (16) different taxpayer corporations, that center around the question of the test to be used in determining whether intangible income can be apportioned to the state.

Other states are experiencing similar growth in litigation. For instance, Pennsylvania has 41 petitions for review implicating *ASARCO*. Virginia has two cases pending at the trial court level, with 11 taxpayers having filed administrative appeals involving refunds which could total $14 million. Petition for a Writ of Certiorari, *Va. Dept. of Tax v. Corning Glass Works, Inc.*, p. 13, Filed May 30, 1991.

Cases on appeal to various state courts include: *Mobil Oil Corp. v. Director*, 11 N.J. Tax 344 (1990), *appeal pending*, N.J. Super. Ct. App. Div. No. A-2326-90 T5; *American Home Products Corp. v. Director*, 11 N.J. Tax 287 (1990), *appeal filed*, N.J. Super. Ct. App. Div., May 2, 1991; *Jewel Cos. v. Montana Dept. of Revenue*, 1990 Mont. Tax LEXIS 81 (Mont. Bd. Tax App. 1990), *appeal pending*, Mont. 1st Jud. Dist., Lewis and Clark Co. Ct. No. BDV-89-294.

> business concept is that it is not, so to speak, unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach.

and at 463 U.S. 178 n.17:

> there is a wide range of constitutionally acceptable variations on the unitary business theme.

This Court has not decided a case, such as the one here, where a single unitary corporation, having an extensive investment and acquisition policy as an integral part of its regular trade or business, receives intangible income from those investments and acquisitions.

The granting of a Writ of Certiorari would be appropriate here due to conflicting opinions and the need for resolution of the uncertainty attendant when decisions concerning the apportionment of intangible income arise.

Both taxpayers and taxing authorities will benefit from the consistent tax treatment of various types of intangible income.

II.

THE SUPREME COURT OF ARKANSAS HAS DISREGARDED THE FACT THAT ASARCO DID NOT CONSIDER THE APPLICATION OF THE UNITARY BUSINESS PRINCIPLE TO A SINGLE UNITARY ENTITY.

The Supreme Court of Arkansas has virtually ignored the fact that the Pine Bluff, Arkansas manufacturing facility and

Hi-Cone were both divisions of Illinois Tool Works, although it acknowledged those facts in its opinion. Based upon the relationship between the divisions and Illinois Tool Works, it can be readily determined that a unitary relationship existed, and substantial benefits, sufficient to respond in the affirmative to the question raised in *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444 (1940) "Whether the state has given anything for which it can ask return", have been received by Illinois Tool Works.

Although this Court has not addressed this issue, the Court in *Silent Hoist & Crane Co. v. Director*, 100 N.J. 1., 494 A.2d 775, *cert. denied*, 474 U.S. 995 (1985), held that the "unitary business" principle analysis contained in *ASARCO* and its progeny are inappropriate where a single entity is before the court.[6] It is appropriate for the Court to address that issue in this case.

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[6]Here, as noted, and as distinct from the Supreme Court cases in which multi-national corporations and their subsidiaries were involved, we are discussing only one corporation. Silent Hoist. It is for this reason that the dividend payor and dividend recipient test enunciated by the Supreme Court in *Mobil, Exxon, ASARCO, Woolworth,* and *Container* and relied upon by Silent Hoist is not applicable. In those cases the question involved for the most part dividends paid from major subsidiaries to their parent, the recipient of the dividend income, controlled the subsidiary, the dividend payor. The test to be developed here involving one corporation is whether the unities apply within the internal operations of Silent Hoist. The focus must be on Silent Hoist's investment activity and other aspects of its corporate business and the role the investment activity plays in those other activities. 494 A.2d, at 784.

III.

THE DECISION BY THE SUPREME COURT OF ARKANSAS WILL HAVE A "SUBSTANTIAL IMPACT" UPON THE ADMINISTRATION OF CORPORATE INCOME TAX LAW.

Justice Steele Hays, in his dissent, squarely faced the reality that the majority "has rushed to judgment in an area that will have substantial impact upon our state." Other states whose courts have used the same rationale in making their decisions wi!' be faced with the same problems. (See *supra*, notes 4 and 5.)

Although the burden of proof has been upon the taxpayer to prove that it does not fall within the parameters of the unitary business principle, the burden has essentially shifted to state agencies to prove that the payor and payee are unitary. In this day of corporate conglomerates, multistate and multinatioal enterprises, these agencies will face an unreasonable burden in determining whether the payor is a "separate and discrete business" or a "unitary business". Tax avoidance will become pervasive.

The definitions of "business income" and "nonbusiness income" which have been adopted by Arkansas are based upon language in Article IV of the Multistate Tax Compact, Uniform Division of Income for Tax Purposes Act (UDITPA). The Multistate Tax Compact has been entered into by twenty-three (23) states, including Arkansas, as full members and by 11 states as associate members. *Silent Hoist and Crane v. Tax Div. Director, supra,* 494 A.2d 775, Note 1. Arkansas and approximately seventeen (17) other states have adopted UDITPA regulations. The UDITPA provisions and

interpretive regulations provide for uniformity and full accountability (without duplication). If the three-factor formula for apportionment of income, which is provided for in UDITPA, was used by all states and applied uniformly, the risk of double taxation would be eliminated.

The Supreme Court of Arkansas overruled *Montgomery Ward, supra,* based, seemingly, upon this Court's decision in *Mobil, Exxon, ASARCO, Woolworth* and *Container.* However, the court misstated the ruling in *Montgomery Ward.* The court in *Montgomery Ward* based its decision upon the definition of "business income", as provided in the Arkansas statutes and UDITPA, and not simply because funds were commingled. The court found that interest earned on loans to related corporations was "business income" because the income arose "in the regular course of the taxpayer's trade or business." Further, "[t]he acquisition, management, and disposition of the working capital most assuredly constituted an integral part of Ward's regular trade or business operation." The court also looked to the use of the interest after it was received. The court found sufficient nexus to meet the provisions of the due process clause because income earned in Arkansas went into working capital, a part of which was used to carry on business in Arkansas. The interest income from the loans became part of the same account. In other words, the income was generated by investments used to advance the operations of the unitary business and the income-producing asset and activity were part of Montgomery Ward's unitary business.

By overruling *Montgomery Ward,* the Supreme Court of Arkansas has undermined the apportionment of income under UDITPA.

Illinois Tool Works and others have made investments an integral part of their unitary businesses, and the decision in *ASARCO* and its progeny should not be so broadly read as to require an exclusive test of unitariness of payor-payee before intangible income can be properly apportioned by non-domiciliary states.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

JOYCE KINKEAD, No. 83100
Attorney, Revenue Legal Counsel
Arkansas Department of
Finance and Administration
Seventh & Wolfe Streets
P.O. Box 1272-L
Little Rock, Arkansas 72203
(501) 682-7030
Counsel of Record

September 23, 1991

APPENDIX A

SUPREME COURT OF ARKANSAS

No. 90-242

Opinion Delivered June 24, 1991

James C. Pledger, Commissioner of Revenues, Dept. of Finance and Administration, State of Arkansas, *Appellant.*

vs.

Illinois Tool Works, Inc., *Appellee.*

An appeal from the Pulaski County Chancery Court, Second Division, No. 88-2406, Honorable John C. Earl, *Chancellor.*

Affirmed.

TOM GLAZE, Associate Justice.

This tax case addresses for the first time the effect of the "unitary business principle" on Arkansas's Uniform Division of Income for Tax Purposes Act (UDITPA), Ark. Code Ann. §§ 26-51-701 to -723 (1987, Supp. 1989). This Act governs how Arkansas imposes its respective corporate and franchise taxes on the earnings of corporations that have multistate and multinational entities. UDITPA is designed to fairly apportion among the states in which a corporation conducts its multistate business a fair amount of value or business income earned by the corporations' activities in each state. Generally, under UDITPA, net taxable "business income" of a corporate taxpayer involved in a multistate business is apportioned upon a well-recognized three-factor formula of tangible property, sales, and payroll.

Appellee, Illinois Tool Works (ITW), is a multistate and multinational corporation having a worldwide business in the manufacturing of tools, fasteners, packaging products and the

leasing of machinery. ITW has operating divisions in seventeen places in the United States and conducts business in several foreign countries. One of ITW's manufacturing plants is located in Pine Bluff, Arkansas. Its corporate headquarters or "commercial domicile" is in Chicago, Illinois.

ITW determined that, for UDITPA purposes, certain capital gains income it had earned in 1981 through 1983 from six different capital assets was "nonbusiness income;" thus it excluded this income when calculating its allocation of taxes to this state.[1] Instead, ITW allocated the income from the sale of these capital assets to its "commercial domicile," in Chicago and the income was taxed under the Illinois corporate income tax laws. ITW's six capital assets were stock in two Japanese manufacturing companies, NISCO and NIFCO; stock in Computer Products, Inc.; undeveloped real property located near ITW's headquarters in Chicago; U.S. Treasury Notes and foreign currency transactions.

The appellant, Arkansas Department of Finance and Administration, disagreed with ITW's classification of this income, asserting that the income constituted "business income" for purposes of Arkansas's UDITPA. Accordingly, appellant assessed ITW additional taxes of approximately $45,164 for the years 1981-1983. After losing an appeal in an administrative hearing, ITW paid the additional taxes under protest and appealed to the chancery court.

The chancery court, relying on five United States Supreme Court cases decided in the 1980s, held that the "unitary business principle" must be utilized in determining whether or not intangible income of multistate or multinational corporate taxpayers is to be classified as "business

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[1] We note that there were originally seven capital assets in dispute, but the appellant conceded that income from the sale of preferred stock was "nonbusiness income" under UDITPA.

income" or "nonbusiness income" for UDITPA purposes. In applying the principle in this case, the chancellor further concluded that ITW's aforementioned income from the sale of its six capital assets was not taxable by the state because the income was in no way connected with ITW's Arkansas business activities. The appellant appeals from the lower court's holding, arguing that the chancellor misapplied the law and made erroneous findings of fact. We find no error and therefore affirm.

Under the UDITPA, "business income" is defined as follows:

> Income arising from transactions and activity in the regular course of the taxpayer's trade or business includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

Ark. Code Ann. § 26-51-701(a) (Supp. 1989). As we noted previously, all "business income" is apportioned to this state using an established formula. Ark. Code Ann. § 26-51-709 (1987). Also, under the Act, "nonbusiness income" is defined as all income other than "business income," § 26-51-701(e), and is allocated specifically to the state having the most logical nexus with the asset producing the "nonbusiness income" (usually its "commercial domicile") rather than being apportioned among the states where the corporation conducts its business.

In the mid-1970s, the Revenue Division of the Arkansas Department of Finance and Administration adopted certain corporate income tax regulations to implement the provisions of Arkansas's UDITPA. Arkansas is a member of the Multistate Tax Compact and the regulations it (and other

states) adopted were suggested by the Multistate Tax Commission (MTC). These regulations were generally referred to as "full apportionment" regulations because they broadly construed the concept of "business income" and very narrowly construed the concept of "nonbusiness income" for UDITPA purposes.

In *Qualls v. Montgomery Ward & Company*, 266 Ark. 207, 585 S.W.2d 18 (1979), this court adopted the "full apportionment" rationale. In *Qualls*, Montgomery Ward received interest from loans made to subsidiary and related corporations none of which were located or did business in Arkansas. Because there was no activity in Arkansas in relation to the loans, Montgomery Ward contended that the interest was "nonbusiness income" taxable in its "commercial domicile" in Illinois. This court disagreed and held that Montgomery Ward's interest income was "business income," not "nonbusiness income," based upon the fact that the interest income was commingled with the company's other general funds to be used for general corporate purposes, which included its business activities in Arkansas.

After the *Qualls* decision, the U.S. Supreme Court changed the "full apportionment" rationale by adding the following two requirements under the Due Process Clause of the fourteenth amendment: 1) a minimal connection or nexus between the inter-state activities and the taxing state; and 2) a rational relationship between the income attributed to the state and the intrastate values of the enterprise. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980). The first nexus requirement is met if the corporation avails itself of the substantial privilege of carrying on business within the state. The Supreme Court labeled the second due process requirement, the "unitary business principle," and explained the application as follows:

[T]he linchpin of apportionability in the field of state

> income taxation is the unitary business principle. In accord with this principle, what appellant (taxpayer) must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course of activities unrelated to the sale of petroleum products in that state.

The cases following *Mobil* all cited the above language and utilized the "unitary business principle" analysis. *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980); *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982); *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983). Under the "unitary business" rationale, as expressed in these decisions, the general test for determining whether a diversified group of businesses had a "unitary business" relationship was to determine whether the income that the state was attempting to tax resulted from functional integration, centralization of management, and economies of scale utilized by the corporate group.

In response to the Supreme Court cases cited above, the Arkansas Revenue Department adopted Regulation 1984-2, which recognized the Supreme Court's due process limitations but applied the "unitary business principle" only to dividend income. In this appeal, the appellant relies on this regulation to argue that since ITW's capital gains were not derived from dividend income, the income is still taxable. We do not agree with the appellant's reading of these Supreme Court cases as limiting the "unitary business principle" analysis only to dividend income.

In *ASARCO*, the Supreme Court addressed Idaho's argument that dividend income received by ASARCO should be considered a part of a "unitary business" if the intangible property is acquired, managed or disposed of for purposes

relating or contributing to the taxpayers' business. The Court rejected Idaho's "full apportionment" argument and held that the dividend income of ASARCO was not taxable by Idaho. In so holding, the Court stated the following:

> This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently, *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of "unitary business" limitation becomes no limitation at all.

Although the main dispute in *ASARCO* concerned dividend income, Idaho also attempted to tax certain ASARCO interest and capital gains from stock sales. However, Idaho and ASARCO had agreed that interest and capital gains derived from these sales should be treated in the same manner as the dividend income. The Supreme Court concurred with the parties' agreement, stating that "One must look principally at the underlying activity, not at the form of investment to determine the propriety of apportionability." The Supreme Court then proceeded to hold that Idaho's attempt to tax this other income also violated the due process clause.

Clearly from reading *ASARCO,* the Supreme Court did not intend for the "unitary business principle" to apply to dividend income only. Accordingly, we hold that the chancellor here was correct in applying the "unitary business principle" analysis to the facts of this case. In sum, we believe the appellant's reading of the Supreme Court cases is much too narrow, and those cases in no way can be construed to uphold the constitutionality of appellant's Regulation 1984-2.

We note the appellant's suggestion that the Supreme Court backed off of its *ASARCO* holding in its most recent case, *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983). In *Container*, the Court stated that there was a requirement that the out-of-state activities of the purported "unitary business" be related in some concrete way to the in-state activities. The Court explained that the functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement — beyond the mere flow of funds arising out of a passive investment or a distinct business operation — which renders formula apportionment a reasonable method of taxation.

Again, we disagree with the appellant's reading of this Supreme Court case. We do not see how the "flow of value" analysis in *Container* benefits the appellant's case here. It appears to be just a rewording of principles set out in the earlier cases. Further, we do not read the *Container* case as limiting the Court's holding in *ASARCO*. To the contrary, *ASARCO* is cited with approval throughout the *Container* case.

In sum, we agree with the chancellor that, in complying with the holdings in the foregoing Supreme Court cases, he was obliged to utilize the "unitary business principle" in this case. Those holdings also require us to overrule the case of *Qualls v. Montgomery Ward*, 266 Ark. 207, 585 S.W.2d 18 (1979), and to declare appellant's Regulation 1984-2 to be unconstitutional. As a side comment, we note that Arkansas is not the first state to have to reevaluate its taxation of multistate corporations after the above Supreme Court cases were decided. *See, e.g., James v. Intern. Tel. & Tel. Corp.*, 654 S.W.2d 865 (Mo. banc 1983); *American Homes Products Corp. v. Limbach*, 49 Ohio St. 3d 158, 551 N.E.2d 201 (1990); *Corning Glass Works v. Va. Dept. of Tax*, 402 S.E.2d 35

(Va. 1991). Now that we have affirmed the chancellor's application of the law in this case, we must address the appellant's challenge that the chancellor's findings of fact in regard to ITW's capital assets are clearly erroneous.

First, in applying the "unitary business principle," the chancellor found that ITW's capital gains income from the sale of its stock interest in NISCO, NIFCO, and CPI was "nonbusiness income" for Arkansas UDITPA purposes. We agree. At no time did ITW hold the majority of the stock in these companies, and while ITW had two or three directors on the companies' boards, there is no showing that ITW had a controlling interest or part. The potential to operate a company as part of a "unitary business" is not dispositive, when in fact there is a discrete business enterprise. *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982). There were no common employees or officers, and ITW did not provide any administrative services to the companies. While NISCO and NIFCO did utilize some of ITW's patented technology, they paid a royalty to ITW for the use of that technology and that royalty income was taxed by ITW as "business income." In sum, the record shows that these companies were operated as discrete and separate businesses and not as a part of a "unitary business."

Further, the record also clearly supports the chancellor's finding that ITW's capital gains from the redemption of U.S. Treasury Notes, foreign currency transactions, and the installment sale of undeveloped land located in Chicago were not an integral part of ITW's regular manufacturing and leasing businesses carried on at the Pine Bluff plant. Instead, we agree with the chancellor's classification of these assets as normal or passive investments of ITW. As pointed out so clearly in *ASARCO*, the business of a corporation requires that it earn money to continue its operations and to provide a return on its invested capital but the use of this money for the

business does not fit the "unitary business principle" test.

For the foregoing reasons, we affirm the chancellor's findings of fact and conclusions of law in applying the "unitary business principle" to the facts of this case. In conclusion, we briefly mention ITW's argument that the chancellor erred in denying its request for attorneys' fees. We simply are unable to reach this issue because ITW failed to file a notice of a cross appeal as required under ARAP Rule 3(d). *See Independence Fed'l S&L Ass'n v. Davis*, 278 Ark. 387, 646 S.W.2d 336 (1983).

Affirmed.

HAYS, J., dissents.

SUPREME COURT OF ARKANSAS

No. 90-242

Opinion Delivered June 24, 1991

James C. Pledger, Commissioner of Revenues, Dept. of Finance and Administration, State of Arkansas, *Appellant.*

vs.

Illinois Tool Works, Inc., *Appellee.*

DISSENTING OPINION

STEELE HAYS, Associate Justice.

I respectfully disagree with the majority, as I believe it has rushed to judgment in an area that will have substantial impact upon our state, and is at the same time, complex, transitional and, above all, abstruse. *See* P. Hartman, *Federal Limitations on State and Local Taxation* § 9:30 (Supp. 1990).

While the United States Supreme Court has begun work on the unitary business principle, as the majority discussed, the application and impact of that principle has generated much litigation and very little harmony. *Id.* at 396. As evidenced just by the complexities of the discussion of this issue, answers are not easily ascertainable and few have been provided by the Supreme Court decisions. *See* e.g., P. Hartman, *Federal Limitations on State and Local Taxation* § 9 (1981 and 1990); J. Hellerstein, *State Taxation, Corporate Income and Franchise Taxes* §§ 8 and 9 (Supp. 1983 and 1989); *Constitutional Law* 96 Harv. L. Rev. 62 (1982); C. Floyd, *The Unitary Business in State Taxation: Confusion at the Supreme Court?*, 1982 B. Y. U. L. Rev. 465. It has even been suggested that because of its complexities, the issue is one the courts are not equipped to handle:

Given the limitations within which the court must

> operate, it is entirely possible that it would be infeasible for the court to examine all of the intricacies of the unitary business and formula apportionment in order to determine whether a business is unitary and fairly subjected to taxation by a standardized apportionment formula. *Fair formula apportionment of divers kinds of business involves a substantial knowledge of the operations of a great variety of industries that are taxed, as well as technical problems of accounting. Courts are hardly equipped satisfactorily to handle such problems. Perhaps the complexities of the problem suggest some broad legislative guidance, fair to the states and the taxpayers, as part of a solution.* [Our emphasis.]

With that in mind, I think it improvident to decide, as the majority does, the constitutionality of a question that the Supreme Court itself has not yet passed on, and which still stands as good law. The argument presented by the state in this case is closely related to the issue in *Qualls v. Montgomery*, 266 Ark. 207, 585 S.W.2d 18 (1979), and has not yet been addressed by the United States Supreme Court, much less overruled, as pronounced by the majority.

In *Qualls*, we addressed the question of interest from loans made by Ward to relative subsidiaries and corporations and whether that should qualify as "business income" and, hence, apportionable. Our current statute provides the same definition relevant in *Qualls*:

> 26-51-701(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income and tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

We held that the interest was *business* income, not, as the majority states, simply because funds were commingled, but because the loans constituted transactions in the "regular course of Ward's business," pursuant to the statutory definition.

We addressed Ward's contention that the corporate relatives were not part of a unitary business, and responded, in essence, that that question need not be answered if the income came from activities that were in the regular course of the taxpayer's trade or business. Or, to put it in terms the United States Supreme Court would now employ, the fact that the loan transactions were part of Ward's regular course of business, was sufficient to find these transactions were part of a unitary business. This is essentially what the state is arguing here — that the investment income is part of ITW's unitary trade or business because the investment activities make up part of ITW's *regular trade and business*.

The Supreme Court's discussions in those cases cited by the majority involved only whether there was unity between the taxpayer and the income source on the basis of the extent and quality of interconnectedness of the taxpayer and the questioned operation. The court did *not* address the question of an income source being part of the taxpayer's unitary business, solely on the basis of the frequency or regularity of an activity, as was the situation in *Qualls*, and specifically here, as argued by the state, that investments were a regular and integral part of its business.

This approach is not novel with either *Qualls* or the appellant. In fact, as pointed out in P. Hartman, *Federal Limitations on State and Local Taxation* § 9:30 at 437-439 (Supp. 1990), in *ASARCO v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), cited by the majority, ASARCO's own counsel agreed that while not present in its case, investments

could be an "adjunct to the actual conduct of the taxpayer's own business," and could be found to be part of a unitary business, and apportionable. And while the United States Supreme Court has not addressed this question, several lower courts have and the inclination is to allow apportionment in those cases. *See e.g., Bendix Corp. v. Director Div. of Tax.*, 568 A.2d 59 (N.J. Super A.D. 1989); *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (1988); *Welded Tube Co. of America v. Comm.*, 515 A.2d 911 (Pa. Comwlth 1986); *Lone Star Steel Co. v. Dolan*, 669 P.2d 916 (Colo. 1983).

The other important factor which the majority fails to mention is the burden of proof in these cases. It is not incumbent upon the state to show sufficient nexus between the apportioned income and the taxpayer. Rather, there is no question but that the burden is on the taxpayer. The state's taxation is of course presumptively constitutional, *Fisher v. Perroni*, 299 Ark. 227, 771 S.W.2d 766 (1989); *Love v. Hill*, 297 Ark. 96, 759 S.W.2d 550 (1988), and to overcome this presumption, the taxpayer has the "distinct burden of showing by clear and cogent evidence," that the statutory scheme "results in extraterritorial values being taxed." *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983); *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980). The question in this case then, boils down to whether ITW showed by clear and cogent evidence that taxation on the investment income was unconstitutional.

There was evidence, as noted by the majority, to show a lack of interconnectedness between ITW and the companies or sources in which it had invested, that is to say, ITW did not have a majority share in its holdings and had no controlling interest, had no common officers or employees and did not provide any administrative services to the companies.

While this may or may not have been clear and cogent

evidence of interconnectedness, such a finding is not controlling here. Rather, we look at the evidence in light of the state's argument that investing was a regular part of the business so as to make the investing operations part of ITW's unitary business. There is no discussion of such evidence in either the appellee's brief or the majority opinion, yet a mere glance at the record substantiates the state's claim. The most critical evidence on this point was given by ITW's vice president and treasurer, David Byron Smith, who testified that all the management of investments was handled through his office; that it was a significant part of the treasurer's operation; that he would spend an hour or so each day working on investments, and that such investments were one of four priorities of the company. He further testified the money received from investments was used as working capital, and working capital was used for investment purposes, but the testimony was ultimately inconclusive on this point. In the face of this testimony, it is clear, to me at least, that ITW has failed to meet its burden.

As the direction of the United States Supreme Court is unsettled, and the consequences far reaching, I cannot join the majority's venture in this area, particularly, where the record has not been sufficiently developed on this question and the appellee's burden of proof was consequently lacking.

APPENDIX B

IN THE CHANCERY COURT OF
PULASKI COUNTY ARKANSAS
Second Division

Illinois Tool Works Inc., *Plaintiff*

vs. No. 88-2046

James C. Pledger, Commissioner of Revenues, Department of Finance and Administration, State of Arkansas, *Defendant.*

MEMORANDUM OPINION

Trial was held in this case on January 18, 1990, at which time the Court admitted into evidence the extensive stipulation of the parties, testimony of witnesses for both the Plaintiff and the Defendant, and certain documentary evidence. From this evidentiary record, and based upon the authorities cited in the briefs and oral arguments of counsel for both parties, the Court makes the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. Illinois Tool Works Inc. (ITW) is a corporation organized and existing under the laws of the State of Delaware, with its principal office and commercial domicile located at Chicago, Illinois. ITW is a publicly traded company with its stock listed on the New York Stock Exchange. ITW is engaged in a multistate and multinational manufacturing and leasing business, primarily producing a variety of patented and nonpatented metal and plastic fastener products and leasing equipment to food and beverage manufacturers for use in packaging their products. During the years 1981 through 1983, those tax years involved in this suit, ITW had 17 separate and distinct operating divisions in the United States

and was the 100% owner of a large number of subsidiaries that operated similar businesses in other countries. (Stip. paras. 1 and 4)

2. James C. Pledger is the Director of the Arkansas Department of Finance and Administration, of which the Revenue Division is the agency charged with the administration of the corporate income tax laws for the State of Arkansas. (Stip. para. 2)

3. During the three years in question, ITW owned and operated a plant at Pine Bluff, Arkansas, which it referred to as the Pine Bluff Division. ITW has been formally authorized and qualified to do business in the State of Arkansas since May 26, 1966. The Pine Bluff Division plant manufactured twist drills, end mills, and taps for sales to automobile, truck and aircraft manufacturers during these three years. The Pine Bluff Division operated from a high of 270 to a low of 190 employees and had gross sales ranging from a high of $14.0 million to a low of $9.0 million during these three years. (Stip. paras. 3 and 5 and testimony of Mr. Gordon)

4. During these three years, ITW's Hi-Cone Division also had a small amount of equipment on lease to beverage manufacturers in Arkansas. Otherwise, no other division of ITW conducted any business activities in the State of Arkansas during these three years. (Stip. para. 5 and testimony of Mr. Smith)

5. For the years 1981, 1982 and 1983, ITW timely filed Arkansas corporate income tax returns with the Revenue Division of the Arkansas Department of Finance and Administration. ITW reported on these returns the "net business income" apportioned to the State of Arkansas by ITW, utilizing the three-factor apportionment formula of Arkansas' Uniform Division of Income for Tax Purposes Act

(UDITPA) (Ark. Code Ann. § 26-51-701, *et. seq.*). Utilizing this UDITPA apportionment formula, ITW reported the following "net business income" as being apportioned to Arkansas and paid the following amounts of Arkansas corporate income tax (Stip. para. 6):

Tax Year	Amount of Arkansas Taxable Income	Amount of Arkansas Corporate Income Tax
1981	$1,372,012.00	$81,761.00
1982	955,469.00	56,768.00
1983	971,814.00	57,749.00

6. These Arkansas corporate income tax returns were audited by an auditor of the Corporate Income Tax Section of the Arkansas Revenue Division, though the auditor made no oral or written contact with any ITW official during the audit phase of these corporate income tax returns. Following the completion of his audit, the Revenue Division proposed to assess additional Arkansas corporate income taxes against ITW for each of these three years in the following amounts (Stip. para. 7, and testimony of Messrs. Gordon and Schimmel):

Taxable Year	Corporate Income Tax Deficiency
1981	$ 7,404.14
1982	415.21
1983	37,344.41
TOTAL:	$45,163.76

7. In this audit, the Revenue Division took the position that the "gain" or "loss" realized by ITW from either the sale or redemption of certain capital assets owned by the company during each of these three tax years constituted "business income," for purposes of Arkansas' UDITPA, as opposed to "nonbusiness income," as originally reported by ITW. A

summary of the disputed capital assets and the exact amount of gain or loss realized by ITW on the questioned disposition of these capital assets are summarized below (Stip. paras. 9 and 11):

Capital Asset	Amount of Gain or Loss Realized		
	1981	1982	1983
NISCO Stock	$2,952,615	—	—
NIFCO Stock	—	—	$11,044,546
CPI Stock	—	—	4,947,649
Preferred Stocks	—	7,417	(105,480)
Investment Land	—	355,300	1,167,673
U.S. Treasury Notes	599,688	362,656	633,750
Foreign Currency Transaction	—	—	3,279,600
Total Capital Gain	$3,552,303	$725,373	$20,967,738

8. ITW protested the proposed audit change to the Board of Hearings and Appeals of the Revenue Division. At the same time, ITW filed amended Arkansas corporate income tax returns for the years 1981 and 1982, reporting thereon certain changes that ITW had agreed to with regard to the "net business income" of the company following a federal income tax audit. The company claimed refunds of Arkansas corporate income tax from the amounts paid on the original returns in the amounts of $2,233.00 for 1981 and $1,092.00 for 1982. (PXs 1 and 2, and testimony of Messrs. Gordon and Schimmel)

9. At an administrative hearing, the Revenue Division conceded that the amounts of gain or loss realized by ITW upon the disposition of the preferred stock that ITW held in the other corporations (listed in paragraph 7 above) did not constitute "business income," for Arkansas UDITPA purposes. In all other respects, the Administrative Law Judge issued an Administrative Decision otherwise approving the proposed assessment in its entirety.

10. Following the issuance of this Administration Decision, ITW timely filed a written "request for revision" with the Commissioner of Revenues, pursuant to the provisions of Ark. Code Ann. § 26-18-405(d), requesting that the proposed assessment of corporate income taxes be abated, in its entirety, because of the decision of the United States Supreme Court in certain cases decided in the early 1980s regarding the application of the UDITPA apportionment formula to income realized from intangible property owned by corporations involved in multistate and multinational businesses. The Commissioner of Revenues acknowledged the cited decisions of the United States Supreme Court in this regard, but he refused to acknowledge their applicability to capital gains realized by ITW for Arkansas corporate income tax purposes. Instead, the Commissioner of Revenues chose to rely upon the decision of the Arkansas Supreme Court in the case of *Qualls v. Montgomery Ward & Co.*, 266 Ark. 207, 585 S.W.2d 18 (1979); the Arkansas Corporate Income Tax Regulations; and the position stated in Revenue Policy Statement 1984-2. (Stip. paras. 13-16; Stip. Exs. C, D, E, F and G; and testimony of Messrs. Gordon and Schimmel)

11. Thereafter, a Formal Notice of Assessment and Demand for Payment was issued to ITW and the company paid a total amount of $45,163.76 in Arkansas corporate income tax and $15,658.40 in interest, "under protest," pursuant to the provisions of Ark. Code Ann. § 26-18-406, and filed this suit for refund of such amounts. (Stip. paras. 17 and 18)

12. Set forth below is a summary of the stipulated and testimonial information produced at trial regarding the nature and relationship of ITW and the seven capital assets questioned by the Arkansas Revenue Division (Stip. para. 10, testimony of Mr. Smith, Corporate Treasurer of ITW):

A. **NISCO Stock.** NISCO is a Japanese manufac-

turing company engaged in the manufacture of screw products. ITW originally purchased a 49% stock interest in NISCO in 1964 when NISCO was formed, because Japanese laws and regulations prohibited more than 49% foreign ownership of this type of Japanese manufacturer. There was no interdependence between NISCO and ITW as to the flow of goods or services. NISCO, in its manufacturing processes, did (and still does) utilize some of ITW's patented technology, under licensing agreement. However, NISCO paid ITW a royalty for the use of such patent rights, as did any other unrelated licensee of ITW's patented technology. The royalty income realized by ITW from this licensing arrangement was included as part of ITW's "business income" for UDITPA purposes. NISCO and ITW agreed to an installment sale of ITW's stock interest in NISCO to NISCO's majority Japanese owners, beginning in 1978, with additional sales in 1979, 1980 and 1981. During the year 1981, ITW held no more than 10% of the issued and outstanding stock of NISCO, and ITW had never held more than 49% of this company's outstanding stock. NISCO and NIFCO did not have any common employees or officers and ITW did not provide any administrative services to NISCO. ITW's investment in NISCO allowed ITW to elect three of the eleven members of the Board of Directors of NISCO, but ITW elected directors rarely attended NISCO Board meetings. The Court finds that NISCO and ITW were operated as discrete and separate businesses that were not operated as part of a unitary business.

B. **NIFCO Stock.** NIFCO is a Japanese manufacturing company that, during these years, was principally engaged in the business of manufacturing plastic fasteners of all types, though it was also involved in other business activities, including the distribution and sale of tobacco products which was a business in which ITW was not engaged anywhere in its worldwide operations. NIFCO's stock began

to be publicly traded on the Tokyo Stock Exchange in 1979. ITW originally purchased its interest in NIFCO's stock sometime in 1967 when NIFCO was formed and this stock was held as a long term investment by ITW. As of the beginning of 1981, ITW held 32.1% of the issued and outstanding stock of NIFCO. There was no interdependence between ITW and NIFCO as to the flow of goods or services. NIFCO did (and still does) utilize some of ITW's patented technology in the production of NIFCO's products, under a licensing arrangement between ITW and NIFCO, and NIFCO paid ITW a royalty for the use of such patent rights, as did any other unrelated licensee of ITW's patented technology. The royalty income realized by ITW from this licensing arrangement was included as part of ITW's "business income" for UDITPA purposes each of these three years. NIFCO and ITW entered into an agreement for ITW to sell some of its NIFCO stock, beginning in 1983, so that NIFCO could qualify to change the status of its listing on the Tokyo Stock Exchange. NIFCO and ITW did not have any common employees or officers, and ITW did not provide any administrative services to NIFCO. ITW's stock interest in NIFCO allowed ITW to elect three of the twelve members of the Board of Directors of NIFCO. However, ITW elected directors rarely attended NIFCO Board meetings. In 1984, all ITW directors resigned from the NIFCO Board because of the difficulty in their attending scheduled Board meetings in Japan. The Court finds that NIFCO and ITW were operated as discrete and separate businesses that were not operated as part of a unitary business.

C. **Computer Products, Inc. (CPI) Stock.** CPI is a manufacturer of power converters for computers and other high technology equipment. CPI's headquarters and commercial domicile are located at Pompano Beach, Florida. Originally, ITW held 23% of the stock of CPI. However, with CPI's substantial issuance of new stock in early 1983, ITW's

interest was diluted to less than 20% of the total issued and outstanding stock of CPI and ITW's decision not to exercise its preemptive rights to purchase additional CPI stock, ITW's investment in CPI originally entitled ITW to elect two (2) of the nine (9) members of the Board of Directors of CPI. There was no interdependence between ITW and CPI as to the flow of goods and services. Since there was no licensing by CPI of ITW's patented technology, there was no payment of royalties by CPI to ITW. CPI and ITW did not have any common employees or officers, and ITW did not provide any administrative services to CPI. The Court finds that CPI and ITW were operated as discrete and separate businesses that were not operated as part of a unitary business.

D. **Preferred Stock.** From time to time, ITW purchased and sold preferred stock issued by other corporations. A summary of ITW's preferred stock transactions, for the years 1981, 1982 and 1983, can be summarized as follows:

1981

Company	No. Shs. Purch.	Purch. Price	No. Shs. Sold	Amount Realized
Chase Bank	7,500	$ 295,312	—	—
P.S.E.G.	4,000	241,760	—	—

1982

Company	No. Shs. Purch.	Purch. Price	No. Shs. Sold	Amount Realized
Chase Bank	—	—	7,500	$ 299,990
P.S.E.G.	—	—	4,000	244,500
Chemical N.Y.	10,000	502,500	—	—
First Chicago	5,000	250,000	—	—
Bank America	20,000	1,000,000	—	—
Manufacturers Hanover Bank	5,000	276,250	—	—
Irving Trust	10,000	500,000	—	—
Carolina Power & Light	7,000	462,000	—	—
NW Central Pipeline	5,000	250,000	—	—

1983

Company	No. Shs. Purch.	Purch. Price	No. Shs. Sold	Amount Realized
Chemical N.Y.	—	—	10,000	$ 552,500
First Chicago	—	—	5,000	280,625
Bank America	—	—	20,000	1,050,000
Manufacturers Hanover Bank	—	—	5,000	280,625
Irving Trust	—	—	10,000	522,500
Carolina Power & Light	—	—	7,000	435,750
NW Central Pipeline	—	—	5,000	251,250
Mohawk Power	10,000	250,000	10,000	240,000
Bank of NY	10,000	500,000	10,000	445,000
Citicorp	10,000	1,000,000	10,000	847,500
Marine Midland	10,000	500,000	10,000	502,500

The Court finds that these capital assets were held for investment purposes by ITW and that the purchase and sale of these shares of preferred stock were not carried on by ITW as a regular or integral part of ITW's worldwide manufacturing and leasing business.

E. **Undeveloped Real Property.** ITW held certain undeveloped real property located across the freeway from its corporate headquarters in Chicago, Illinois. This undeveloped land was purchased by ITW before 1973 and it was carried on ITW's chart of accounts as "investment land." This parcel of real property was never utilized by ITW in any of its active businesses. ITW did not have an employee who was charged with the responsibility of overseeing the development of its real estate. This particular property was leased to an individual, who used it principally as a farm for the raising of cash crops that were sold by this lessee. The cost or fair market value of this particular parcel of undeveloped property was

never included by ITW in the "property factor" for UDITPA apportionment purposes. In 1982, ITW agreed to an installment sale of this real property. In 1982 and 1983, ITW completed the installment sale of this undeveloped land that had been principally used for farming. The Court finds that this undeveloped land was held by ITW as an investment and that property was not utilized as an integral part of ITW's regular worldwide manufacturing and leasing business.

F. **United States Treasury Notes.** From time to time, ITW purchased (usually at a discount) United States Treasury Notes and held such notes until they matured. The capital gains reported in 1981, 1982 and 1983 by ITW for "capital gains" on U.S. Treasury Notes reflected a recognition, for income tax purposes, of the amount of discount realized by ITW upon the redemption of these notes by the United States Teasury at their face value upon maturity. These U.S. Treasury Notes were generally held by ITW for several years before they matured. ITW did not buy and sell these U.S. Treasury Notes; the company simply bought the notes at a discount and held them until they matured. The Court finds that these U.S. Treasury Notes were held by ITW for investment purposes and the purchase of these U.S. Treasury Notes by ITW was not an integral part of ITW's regular worldwide manufacturing and leasing business.

G. **Foreign Currency Transactions. (Hedging Contracts).** Before a change was made near the end of 1981, Financial Accounting Standard Board (FASB) No. 8 required a United States based multinational company to recognize any change in the foreign currency exchange rates on the multinational company's current profit and loss statement for each year. Thus, a foreign subsidiary of a U.S. multinational company may have made profit from its actual operations, but, due solely to a fluctuation of the exchange rates of the currency of the country where the subsidiary was located

against the United States dollar, the foreign subsidiary's income might have been lowered or eliminated entirely for consolidated financial statement purposes. During 1981, the Financial Accounting Standards Board adopted FASB No. 52. FASB No. 52 removed this flow-through reporting requirement that would have affected the consolidated profit and loss statement of the multinational group for "financial statement" purposes. Because of ITW's worldwide operations, ITW had, in the five years preceding 1981, selectively "hedged" some foreign currency exposures because of the fluctuation in the United States dollar against the currencies of the countries where it had operating subsidiaries. These currency hedging transactions were referred to as "balance sheet" hedges (which covered several years before the contracts were terminated), as opposed to a "specific hedge" to cover the payment of a certain dividend or interest payment. ITW entered into these "balance sheet hedges" on an average of less than once per year. During 1981, before the adoption of FASB No. 52, ITW entered into a two-year contract on British pounds. ITW did not enter into any "balance sheet hedges" after the change in FASB No. 52, During 1983, for income tax purposes (but not for financial statement purposes), ITW realized a $3,279,600 capital gain from the closing of this "hedging transaction" involving the sale of British pounds. This was the only gain or loss realized from a "hedging transaction" by ITW in the year 1983. The Court finds that this "balance sheet hedge" purchase of British pounds in 1981, and their sale in 1983, which resulted in a substantial capital gain for ITW was a transaction that was not an integral part of ITW's regular worldwide manufacturing and leasing business.

13. The Court finds that the seven capital assets described and discussed in paragraph 12 were acquired, managed and disposed of entirely by personnel located at ITW's Chicago, Illinois, headquarters, generally employees

within the corporate treasurer's office. The decisions with regard to the management of ITW's investment in the NISCO, NIFCO, CPI and preferred stock of numerous unrelated third party companies, as well as the management of the investment land in Chicago, Illinois, the purchase of U.S. Treasury Notes at a discount, and decisions to enter into a few "balance sheet" foreign currency hedging transactions were matters that had absolutely nothing to do with ITW's worldwide manufacturing and leasing businesses. In particular, the Court finds that there was no connection between the management of these seven categories of capital assets at ITW's commercial domicile and headquarters in Chicago, Illinois, and ITW's manufacturing operations at its Pine Bluff, Arkansas, division plant or its leasing of machinery to beverage companies operating in the State of Arkansas.

14. ITW reported the gain or loss it realized in the years 1981, 1982 and 1983 from the sale or disposition of the seven categories of capital assets described in paragraph 12, above, on ITW's Illinois corporate income tax return.

15. Any finding of fact that is deemed to be a conclusion of law is hereby adopted as a conclusion of law.

CONCLUSIONS OF LAW

1. The Court has jurisdiction over the subject matter and the parties to this action, pursuant to the provisions of Ark. Code Ann. § 26-18-406.

2. Arkansas adopted the Uniform Division of Income for Tax Purposes Act (UDITPA) (Ark. Code Ann. § 26-51-701 through § 26-51-723) as Act 413 of 1961. More than half of the states that impose a corporate income tax have adopted UDITPA, or use a similar three-factor formula for apportioning the "business income" among the states in which the

multistate or multinational corporation conducts its business.

3. Under the provisions of Arkansas' adoption of UDITPA, all of the "business income" of the multistate corporate taxpayer is apportioned among the states in which the corporation conducts its business, based upon the three-factor formula of the proportion of the total value of the property, the total amount of sales, and the total amount of payroll for the corporation in Arkansas, as compared to the corporation's property, sales and payroll everywhere. Thus, UDITPA is designed to fairly apportion among the states in which a corporation conducts its multistate business a fair amount of the value or income earned by the corporation's activities in each state. This method of apportioning "net business income" of a multistate corporate taxpayer was specifically approved by the United States Supreme Court in the case of *Northwestern Portland States & Cement Co. v. Minnesota*, 358 U.S. 450 (1959).

4. However, the UDITPA provisions aiso take into consideration the fact that certain income of a corporation has such peculiar nexus wtih one taxing juisdiciton, that such income, if not an integral part of the multistate corporation's regular business activities, will be deemed to be "nonbusiness income" and will be allocated (as opposed to apportioned) to only the taxing jurisdiction having the substantial nexus with that income. This provision of UDITPA is designed to meet the "due process" requirements of the Fourteenth Amendment to the United States Constitution and Art. 2 § 8 of the Arkansas State Constitution.

5. In the mid-1970s, the Revenue Division of the Arkansas Department of Finance and Administration adopted certain corporate income tax regulations to implement the provisions of Arkansas' UDITPA i.e. Reggs. 1977-4, Regulations Nos. IV.1(a), (c); IV.6(2); IV.7(3); IV.7(a);

and IV.8. These regulations had been promulgated and suggested to Arkansas (and to the other states who had ratified the Multistate Tax Compact), by the Multistate Tax Commission (MTC). These corporate income tax regulations promulgated by the MTC were generally referred to as the "full apportionment" regulations, because such income tax regulations broadly construed the concept of "business income" for UDITPA purposes, and very narrowly construed the concept of "nonbusiness income" for UDITPA purposes.

6. In 1979, the Arkansas Supreme Court reversed the Chancellor of the Pulaski County Chancery Court, in the case of *Qualls v. Montgomery Ward & Company*, 266 Ark. 207, 585 S.W.2d 18 (1979) in a case involving the determination of whether interest income received by Montgomery Ward & Company from its subsidiaries, affiliates and parent corporation constituted "business income" or "nonbusiness income" for Arkansas UDITPA purposes. In this *Montgomery Ward* decision, the Arkansas Supreme Court adopted a rationale for holding the interest income in question to be "business income" as opposed to "nonbusiness income," mainly based upon the fact that the moneys that constituted the principal of the loans and the interest received from the loans came from what the Court referred to as the excess working capital of Montgomery Ward. Thus, the Arkansas Supreme Court adopted essentially the "full apportionment" concept of the MTC promulgated income tax regulations that had been adopted by the Revenue Division of the Arkansas Department of Finance and Administration.

7. Subsequently, however, the United States Supreme Court, beginning in 1980, issued a series of five opinions that specifically addressed the question of the "business income" versus "nonbusiness income" classification of earnings of a multistate or multinational corporation from its intangible property, i.e. capital gains, interest, dividends, royalties, etc.

These cases are: *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982); *F.W. Woolworth Co. v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354 (1982); and *Container Corp. of America v. Franchise Tax Board*, 436 U.S. 159 (1983). In these cases, the United States Supreme Court promulgated what it refers to as the "unitary business principle" standard for determining whether or not intangible income of a multistate or multinational corporate taxpayer is to be classified as "business income" or "nonbusiness income" for UDITPA purposes.

8. To satisfy the due process requirements of the Fourteenth Amendment to the United States Constitution, the Supreme Court has said a state must satisfy that the income earned by multistate or multinational corporations must be income that is generated by a "unitary business," before the states in which each multistate or multinational corporations conduct their business activities can constitutionally subject this income from intangible property to taxation in such states as "business income" for UDITPA purposes.

9. In all five cases, the United States Supreme Court defined what it meant by the underlying economic realities of a unitary business as follows (*Mobil Oil*, 440 U.S. at 439):

> [T]he linchpin of apportionability in the field of state income taxation is the unitary-business principle. In accord with this principle, what Appellant must show in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course of activities unrelated to the sale of petroleum products in that state . . . In the absence of any

> proof of discrete business enterprise, Vermont was entitled to conclude that the dividend income's foreign source did not destroy the requisite nexus with in-state activities. (Citations omitted)

10. It is unquestioned that the burden of proof, in any audit dispute, is upon the corporate taxpayer. The Supreme Court stated this burden to be as follows in the *Exxon* case (447 U.S. at 223-224):

> In order to exclude certain income from the apportionment formula, the company must prove that the "income was earned in the course of activities unrelated to the sale of petroleum products in that state." . . . The Court looks at the "underlying economic realities of a unitary business," and the income must derive from "unrelated business activity," which constitutes a "discrete business enterprise," . . . (Citations omitted)

In each of these cases, the Supreme Court said that a "unitary business" was one that resulted "from functional integration, centralization of management and economics of scale" utilized by the corporate group.

11. The United States Supreme Court specifically refused to accept the "full apportionment" concept that had been put forward by the MTC and its member states, i.e. if the original source of the funds was excess working capital or if the tangible income was deposited into working capital then the income would be "business income" for UDITPA purposes. The Court specifically held in *ASARCO* (458 U.S., at 326):

> This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a

return on its invested capital. Consequently, *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. When less ambitious interpretations are employed, the result is simply arbitrary.

We cannot accept, consistently with recognized due process standards, a definition of "unitary business" that would permit nondomiciliary States to apportion and tax dividends "[W]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing state. . . ." In such a situation, it is not true that the "state has given anything for which it can ask return." (Citations omitted)

12. In *ASARCO*, the United States Supreme Court held that the due process clause of the Fourteenth Amendment provided (458 U.S. at 315):

As a general principle, a State may not tax value earned outside its borders. . . . The broad inquiry in a case such as this, therefore, is "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return." (Citations omitted)

13. The Arkansas Revenue Division's response to these five Supreme Court cases, was to issue Revenue Policy Statement 1984-2 on April 24, 1984. This Revenue Policy Statement stated that the Revenue Division would apply the "unitary business principle"

standard of the *ASARCO, Woolworth* and *Container Corp.* cases only to "dividend" income of a multistate or multinational corporate taxpayer, but, with regard to all other types of income from intangible property (including "capital gains," "interest," "royalties," etc.), that the Revenue Division would continue to apply the MTC promulgated regulations that it had previously adopted and the prior decision of the Arkansas Supreme Court in its *Montgomery Ward* decision.

14. To begin the due process analysis applicable in this case, the Court finds that the Revenue Division's reliance upon the Arkansas Supreme Court's decision in the 1979 *Montgomery Ward* case is misplaced. The decisions of the United States Supreme Court in *Mobil Oil, Exxon, ASARCO, Woolworth* and *Container Corp.* have totally rejected the rationale of the due process standards as adopted by the Arkansas Supreme Court in its *Montgomery Ward* decision. Also, these five decisions by the United States Supreme Court overruled decisions of a number of Arkansas' sister states, that were similar in their rationale to the *Montgomery Ward* decision. The United States Supreme Court has clearly established that the "unitary business principle" standard must be applied in all cases involving income earned from intangible property of a multistate or multinational corporation, not just "dividend" income. In fact, the Supreme Court in the *ASARCO* case specifically held that this same standard should apply to "capital gains" and "interest" as it did to the "dividends," which was the principle issue involved in that case.

15. With regard to the "capital gain" realized by ITW from its sale of its stock interest that it held in NISCO, NIFCO and CPI, this Court concludes that the company correctly reported this "capital gain" as "non-

business income," for Arkansas UDITPA purposes. There was absolutely no control exercised over these three companies by ITW, and the United States Supreme Court held in the *Woolworh* case that "potential for control" was not enough to cause these companies to form a "unitary business" for UDITPA purposes. The Court finds that the characterization of the "capital gains" realized from the disposition of these assets should have been treated in the same manner as the Revenue Division conceded that the capital gains or capital losses realized by ITW from the disposition of its interest in the preferred stock of other corporations should have been treated as "nonbusiness income" for Arkansas UDITPA purposes.

16. Likewise, with regard to the capital gains that ITW realized from the redemption of the U.S. Treasury Notes, the sale of the single "balance sheet" hedge in British pounds, and the installment sale of the undeveloped land across the freeway from its Chicago, Illinois, headquarters, such income did not arise from activities that were not an integral part of ITW's regular worldwide manufacturing and leasing businesses. In particular, such transactions had absolutely nothing to do with the manufacturing and leasing activities of ITW at its Pine Bluff Division manufacturing plant or in the few instances in which its Hi-Cone Division leased packaging machinery to beverage companies operating in the State of Arkansas. In essence, Arkansas has not supplied anything to ITW for which it can seek to recoup a tax on the seven capital assets in dispute in this audit controversy.

17. The capital gains realized by ITW from the disposition of these assets may have added to the corporation's overall riches, but they were not in any way connected with ITW's Arkansas business activities. The management activities of these seven investment assets at ITW's headquarters and commercial domicile in Chicago,

Illinois, were carried on by the company as an integral part of ITW's regular business activities; but, instead, were merely incidental activities conducted solely in the State of Illinois. ITW reported these capital gains as income to the State of Illinois and paid Illinois corporate income tax on such capital gains in accordance with Illinois law. ITW correctly reported these capital gains as "nonbusiness income" for Arkansas UDITPA purposes, and the Revenue Division of the Arkansas Department of Finance and Administration cannot properly interpret, under any conceivable due process standard, that Arkansas' UDITPA could reach this type of income for corporate income tax purposes.

18. The Court declines the request of ITW to impose sanctions in the amount of $5,000.00 against the Commissioner of Revenues pursuant to the provisions of Ark. Code Ann. § 16-22-309. Likewise, even though the Court finds that the position of the Revenue Division does not meet the constitutional standards of due process required by either the Fourteenth Amendment of the United States Constitution or Art. 2 § 8 of the Arkansas State Constitution, the Court declines to impose sanctions against the Commissioner of Revenues in the form of the imposition of the Plaintiff's attorneys' fees, pursuant to the provisions of 42 U.S.C. §§ 1983 and 1988.

19. Any conclusion of law deemed to be a finding of fact, is hereby adopted as a finding of fact.

Entered this 23rd day of March, 1990.

/s/ The Honorable John C. Earl
Chancellor

APPROVED AS TO FORM:

/s/ Eugene G. Sayre
Jack, Lyon & Jones, P.A.
425 West Capitol Avenue
3400 TCBY Tower
Little Rock, AR 72201
(501) 375-1122
Solicitor for Plaintiff

/s/ Philip Raia
Revenue Legal Counsel
Revenue Division
Ark. Dept. of Finance & Admin.
P.O. Box 1272-L
Little Rock, AR 72203
Solicitor for Defendant

IN THE CHANCERY COURT OF
PULASKI COUNTY ARKANSAS
Second Division

Illinois Tool Works Inc., *Plaintiff*

vs. No. 88-2046

James C. Pledger, Commissioner of Revenues, Department of Finance and Administration, State of Arkansas, *Defendant*.

JUDGMENT

This case having come on for trial on January 18, 1990, and the Court having considered the documents, testimony and stipulations introduced into evidence, and the written and oral arguments of counsel for the respective parties; and the Court having made written findings of fact and conclusions of law contained in the Memorandum Opinion entered in this case of even date, it is hereby,

ORDERED, ADJUDGED AND DECREED that the Plaintiff, Illinois Tool Works Inc., shall have and recover from the State of Arkansas, the following amounts of corporate

income tax and interest that have been overpaid for the following years:

Year	Amount	Interest
1981	$ 8,337.14	$ 3,659.07
1982	1,263.21	171.89
1983	37,344.41	11,827.44
TOTAL	$46,944.76	$15,658.40

together with interest at the rate of 10% per annum that was accrued, from the date of payment by the Plaintiff on July 15, 1987, until paid by the Defendant. It is further,

ORDERED, ADJUDGED AND DECREED that the parties are to bear their own costs in the prosecution of this action.

Entered this 23rd day of March, 1990.

/s/ Honorable John C. Earl
Chancellor

APPROVED AS TO FORM:

/s/ Eugene G. Sayre
Jack, Lyon & Jones, P.A.
425 West Capitol Avenue
3400 TCBY Tower
Little Rock, AR 72201
(501) 375-1122
Solicitor for Plaintiff

/s/ Philip Raia
Revenue Legal Counsel
Revenue Division
Ark. Dept. of Finance & Admin.
P.O. Box 1272-L
Little Rock, AR 72203
Solicitor for Defendant

APPENDIX C

[§ 14-503] Regs. 1977-4 [Multistate Tax Compact and Uniform Division of Income for Tax Purposes Act — Business and Nonbusiness Income]. — Pursuant to the authority of Arkansas Statutes Section 84-2041, and in compliance with Section 3 of Act 434 of the Acts of Arkansas for the year 1967, and Act 583 of the Acts of Arkansas for the year 1973, the Director of the Department of Finance and Administration, with the approval of the Governor, does hereby promulgate the following rules and regulations for the administration of Article IV of the Multistate Tax Compact and the Uniform Division of Income for Tax Purposes Act, found in Arkansas Statutes Annotated §§ 84-2055 through 84-2073 and 84-4101, Article IV.

These regulations are intended to set forth rules concerning the application of the apportionment and allocation provisions of Article IV in the Multistate Tax Compact and their counterpart, Ark. Stats. § 84-2055 through § 84-2073, with regard to business income.

Ark. Stats. § 84-2055(a). " 'Business income' means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. Business income shall include any dividends or interest paid to a corporation having its commercial domicile in this state by another corporation provided the recipient owns at least 50% of the outstanding capital stock of the distributing or paying corporation. If the recipient corporation owns less than 50% of the outstanding capital stock of the distributing or paying corporation, such dividends or interest shall be non-business income and shall be allocated and taxed as such."

(e). " 'Non-business income' means all income

other than business income."

The definition under Article IV of Ark. Stats. § 84-4101 and the Multistate Tax Compact is substantially the same as that set forth in Ark. Stats. § 84-2055 with the exception of the dividends or interest provision of a corporation having its commercial domicile in this State.

Regulation Number IV.1.(a). Business and Nonbusiness Income Defined. — Article IV.1.(a) defined "business income" as income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is business income. For purposes of administration of Article IV, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income.

Nonbusiness income means all income other than business income.

The classification of income by labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, nonoperating income, etc., is of no aid in determining whether income is business or nonbusiness income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity which are the elements of a particular trade or business. In general all transactions and activities of the taxpayer which are

dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or business.

Regulation Number IV.1.(c). Business and Nonbusiness Income: Application of Definitions. — The following are rules and examples for determining whether particular income is business or nonbusiness income. (The examples used throughout these regulations are illustrative only and do not purport to set forth all pertinent facts.)

(1) *Rents from real and tangible personal property.* — Rental income from real and tangible property is business income if the property with respect to which the rental income was received is used in the taxpayer's trade or business.

Example (i): The taxpayer operates a multistate car rental business. The income from car rentals is business income.

Example (ii): The taxpayer is engaged in the heavy construction business in which it uses equipment such as cranes, tractors, and earth-moving vehicles. The taxpayer makes short-term leases of the equipment when particular pieces of equipment are not needed on any particular project. The rental income is business income.

Example (iii): The taxpayer operates a multistate chain of men's clothing stores. The taxpayer purchases a five-story office building for use in connection with its trade or business. It uses the street floor as one of its retail stores and the second and third floors for its general corporate headquarters. The remaining two floors are leased to others. *The rental of the two floors is incidental to the operation of*

the taxpayer's trade or business. The rental income is business income.

Example (iv): The taxpayer operates a multistate chain of grocery stores. It purchases as an investment an office building in another state with surplus funds and leases the entire building to others. The net rental income is not business income of the grocery store trade or business. Therefore, the net rental income is nonbusiness income.

Example (v): The taxpayer operates a multistate chain of men's clothing stores. The taxpayer invests in 20-story office building and uses the street floor as one of its retail stores and the second floor for its general corporate headquarters. The remaining 18 floors are leased to others. The rental of the eighteen floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. The net rental income is not business income of the clothing store trade or business. Therefore, the net rental income is nonbusiness income.

Example (vi): The taxpayer constructed a plant for use in its multistate manufacturing business and 20 years later the plant was closed and put up for sale. The plant was rented for a temporary period from the time it was closed by the taxpayer until it was sold 18 months later. The rental income is business income and the gain on the sale of the plant is business income.

Example (vii): The taxpayer operates a multistate chain of grocery stores. It owned an office building which it occupied as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. The old building was rented to an investment company under a five-year lease. Upon expiration of the lease, taxpayer sold the building at a gain

(or loss). The net rental income received over the lease period is nonbusiness income and the gain (or loss) on the sale of the building is nonbusiness income.

Regulation Number IV.6(2). Gains or losses from sales of assets. Gain or loss from the sale, exchange or other disposition of real or tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business. However, if such property was utilized for the production of nonbusiness income or otherwise was removed from the property factor before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income.

Example (i): In conducting its multistate manufacturing business, the taxpayer systematically replaces automobiles, machines, and other equipment used in the business. The gains or losses resulting from those sales constitute business income.

Example (ii): The taxpayer constructed a plant for use in its multistate manufacturing business and 20 years later sold the property at a gain while it was in operation by the taxpayer. The gain is business income.

Example (iii): Same as (ii) except that the plant was closed and put up for sale but was not in fact sold until a buyer was found 18 months later. The gain is business income.

Example (iv): Same as (ii) except that the plant was rented while being held for sale. The rental income is business income and the gain on the sale of the plant is business income.

Example (v): The taxpayer operates a multistate chain of grocery stores. It owned an office building which is occupied

as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and large building elsewhere for its corporate headquarters. The old building was rented to an unrelated investment company under a five-year lease. Upon expiration of the lease, taxpayer sold the building at a gain (or loss). The gain (or loss) on the sale is nonbusiness income and the rental income received over the lease period is nonbusiness income.

Regulation Number IV.7(3). Interest. Interest income is business income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible is related to or incidental to such trade or business operations.

Example (i): The taxpayer operates a multistate chain of department stores, selling for cash and on credit. Service charges, interest, or time-price differentials and the like are received with respect to installment sales and revolving charge accounts. These amounts are business income.

Example (ii): The taxpayer conducts a multistate manufacturing business. During the year the taxpayer receives a federal income tax refund and collects a judgment against a debtor for the business. Both the tax refund and the judgment bore interest. The interest income is business income.

Example (iii): The taxpayer is engaged in a multistate manufacturing and wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, rain and storm damage, machinery replacement, etc. The moneys in those accounts are invested at interest. Similarly, the taxpayer temporarily invests funds intended for payment of federal,

state and local tax obligations. The interest income is business income.

Example (iv): The taxpayer is engaged in a multistate money order and traveler's checks business. In addition to the fees received in connection with the sale of the money orders and traveler's checks, the taxpayer earns interest income by the investment of the funds pending their redemption. The interest income is business income.

Example (v): The taxpayer is engaged in a multistate manufacturing and selling business. The taxpayer usually has working capital and extra cash totaling $200,000 which it regularly invests in short-term interest bearing securities. The interest income is business income.

Example (vi): In January the taxpayer sold all the stock of a subsidiary for $20,000,000. The funds are placed in an interest-bearing account pending a decision by management as to how the funds are to be utilized. The interest income is nonbusiness income.

Regulation Number IV.7(a). Dividends. Dividends are business income where the stock with respect to which the dividends are received arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the stock is related to or incidental to such trade or business operations.

Example (i): The taxpayer operates a multistate chain of stock brokerage houses. During the year the taxpayer receives dividends on stock it owns. The dividends are business income.

Example (ii): The taxpayer is engaged in a multistate manufacturing and wholesaling business. In connection with

that business the taxpayer maintains special accounts to cover such items as workmen's compensation claims, etc. A portion of the moneys in those accounts is invested in interest-bearing bonds. The remainder is invested in various common stocks listed on national stock exchanges. Both the interest income and any dividends are business income.

Example (iii): The taxpayer and several unrelated corporations own all of the stock of a corporation whose business operations consist solely of acquiring and processing materials for delivery to the corporate owners. The taxpayer acquired the stock in order to obtain a source of supply of materials used in its manufacturing business. The dividends are business income.

Example (iv): The taxpayer is engaged in a multistate heavy construction business. Much of its construction work is performed for agencies of the *federal government* and various state governments. Under state and federal laws applicable to contracts for these agencies, a contractor must have adequate bonding capacity, as measured by the ratio of its current assets (cash and marketable securities) to current liabilities. In order to maintain an adequate bonding capacity the taxpayer holds various stocks and interest-bearing securities. Both the interest income and any dividends received are business income.

Example (v): The taxpayer receives dividends from the stock of its subsidiary or affiliate which acts as the marketing agency for products manufactured by the taxpayer. The dividends are business income. [This example is limited by *Ark. Stats.* § 84-2055(a).]

Example (vi): The taxpayer is engaged in a multistate glass manufacturing business. It also holds a portfolio of stock and interest-bearing securities, the acquisition and holding of

which are unrelated to the manufacturing business. The dividends and interest income received are nonbusiness income.

Regulation Number IV.8. Patent and copyright royalties. Patent and copyright royalties are business income where the patent or copyright with respect to which the royalties were received arises out of or [was] created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the patent or copyright is related to or incidental to such trade or business operations.

Example (i): The taxpayer is engaged in the multistate business of manufacturing and selling industrial chemicals. In connection with that business the taxpayer obtained patents on certain of its products. The taxpayer licensed the production of the chemicals in foreign countries, in return for which the taxpayer receives royalties. The royalties received by the taxpayer are business income.

Example (ii): The taxpayer is engaged in the music publishing business and holds copyrights on numerous songs. The taxpayer acquires the assets of a smaller publishing company, including music copyrights. These acquired copyrights are thereafter used by the taxpayer in its business. Any royalties received on these copyrights are business income.

Example (iii): Same as example (ii), except that the acquired company also held the patent on a type of phonograph needle. The taxpayer does not manufacture or sell phonorecords or phonograph equipment. Any royalties received on the patent would be nonbusiness income.

This Regulation shall be in full force and effect on and after December 31, 1977.

APPENDIX D

ARKANSAS DEPARTMENT OF FINANCE AND ADMINISTRATION REVENUE DIVISION

Revenue Policy Statement 1984-2

Recent United States Supreme Court decisions mandate changes in Revenue Policy concerning the taxation of income from intangibles received by multistate and multinational corporations. This statement sets forth Revenue Division Policy as regards taxation of income received from intangibles by multistate and multinational corporations.

1. **UNITARY COMBINED REPORTING:** Arkansas has not previously utilized a combined reporting method for multistate or multinational corporations. Arkansas Corporate Income Tax Law does not specifically require or allow combined reporting. Therefore, the Revenue Division will not utilize unitary combined reporting to tax multistate or multinational corporations. Also, the Revenue Division will not accept returns filed on a unitary combined report basis.

2. **INCOME FROM INTANGIBLES**

a) In *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), *F.W. Woolworth Co. v. Taxation and Revenue Department*, 458 U.S. 354 (1982), and *Container Corporation of America v. Franchise Tax Board*, ___ U.S. ___ (1983), the Court set due process limitations on the taxation of dividends paid between related corporations. These dividends are not apportionable business income pursuant to Ark. Stat. Ann. § 84-2055 et seq. unless the Court's due process requirements are met. The Revenue Division will consider these dividends to be apportionable only when the payor and payee corporations are "unitary" corporations which meet the Court's due process requirements.

b) **INCOME FROM OTHER INTANGIBLES**

Income from any intangible other than dividends is apportionable if it qualifies as business income pursuant to Ark. Stat. Ann. § 84-2055 et seq. and the Multistate Tax Compact Regulations adopted by Arkansas.

Issued this 24th day of April, 1984, in the City of Little Rock, Arkansas.

/s/ Mahlon Martin, Director
Department of Finance
and Administration

/s/ Charles D. Ragland
Commissioner of Revenues

APPENDIX E

EXHIBIT A

Listing of ITW's ownership in subsidiaries and affiliates, as set forth in the Forms 10-K filed by ITW with the Securities and Exchange Commission for the following years:

1981
ILLINOIS TOOL WORKS INC.
Subsidiaries of the Registrant

Company	Relationship	Percent Ownership
Bema Film Systems Inc. — Illinois	Subsidiary	100
Chicago Switch Inc. — Illinois	Subsidiary	100
Devcon Corporation — Massachusetts	Subsidiary	100
Devcon Canada Limited — Canada (1)	Subsidiary	100
Devcon Export Corporation — Massachusetts (1)	Subsidiary	100
Devcon de Mexico, S.A. — Mexico (1)	Subsidiary	100
Devcon Limited — Ireland	Subsidiary	100
W. A. Deutsher Pty. Ltd. — Australia	Subsidiary	100
Illinois Tool Works South Africa Pty. Ltd.—South Africa	Subsidiary	100
ITW Asia (Pte.) Limited — Singapore	Subsidiary	100
ITW Ateco G.m.b.H. — Germany	Subsidiary	100
ITW Canada Inc. — Canada	Subsidiary	100
ITW Caribe, Inc. — Delaware	Subsidiary	100
ITW Deutsher Ltd. — New Zealand (2)	Subsidiary	100
ITW Espana S.A. — Spain (3)	Subsidiary	100

1981 continued

Company	Relationship	Percent Ownership
ITW Export Corporation — Delaware	Subsidiary	100
ITW Fastex-Italia S.p.A. — Italy	Subsidiary	100
ITW de France S.A. — France	Subsidiary	100
ITW Hi-Cone Holdings Limited — Ireland	Subsidiary	100
ITW Hi-Cone Limited — Ireland (4)	Subsidiary	100
ITW Industria e Comercio Ltda. — Brazil	Subsidiary	99.1
ITW International Inc. — Delaware	Subsidiary	100
ITW Limited — England	Subsidiary	100
ITW Paktron Limited — Taiwan	Subsidiary	100
Packaging Leasing Systems Inc. — Delaware	Subsidiary	80
Plastiglide Limited — Canada (5)	Subsidiary	100
Plastiglide Manufacturing Corporation — Delaware	Subsidiary	100
Arrendadora Tlalnepantla. S.A. de C.V. — Mexico	Subsidiary-Affiliate	49
Computer Products, Inc. — Florida	Subsidiary-Affiliate	23
Coolawin Resources Limited — Australia (6)	Subsidiary-Affiliate	26.5
Envases Multipac. S.A. de C.V. — Mexico	Subsidiary-Affiliate	49
INCAP-Industria de Carregadores Plasticos S.A. — Brazil	Subsidiary-Affiliate	49
Inmobiliaria Cit. S.A. de C.V. — Mexico	Subsidiary-Affiliate	49

1981 continued

Company	Relationship	Percent Ownership
Metalurgica Mapri-Illinois Ltda. — Brazil	Subsidiary-Affiliate	40
Multipak de Venezuela C.A. — Venezuela	Subsidiary-Affiliate	48
Nifco Inc. — Japan	Subsidiary-Affilite	32.1
Nihon Devcon Kabushiki Kaisha — Japan (7)	Subsidiary-Affiliate	49.2
Ricks Exploration Company — Oklahoma	Subsidiary-Affiliate	45

(1) Wholly owned subsidiary of Devcon Corporation.
(2) Wholly owned subsidiary of W. A. Deutsher Pty. Ltd.
(3) Wholly owned subsidiary of ITW International Inc.
(4) Wholly owned subsidiary of ITW Hi-Cone Holdings Limited.
(5) Wholly owned subsidiary of Plastiglide Manufacturing Corporation.
(6) 26.5% owned by W. A. Deutsher Pty. Ltd.
(7) 49.2% owned by Devcon Corporation.

1982

Company	Relationship	Percent Ownership
Bema Film Systems Inc. — Illinois	Subsidiary	100
Chicago Switch Inc. — Illinois	Subsidiary	100
Devcon Corporation — Massachusetts	Subsidiary	100
Devcon Canada Limited — Canada (1)	Subsidiary	100
Devcon Export Corporation — Massachusetts (1)	Subsidiary	100
Devcon de Mexico, S.A. — Mexico (1)	Subsidiary	100

1982 continued

Company	Relationship	Percent Ownership
Devcon Holdings Inc. — Delaware (1)	Subsidiary	100
Devcon Limited — Ireland	Subsidiary	100
W. A. Deutsher Pty. Ltd. — Australia	Subsidiary	100
Heartland Components Inc. — Minnesota	Subsidiary	100
Illinois Tool Works South Africa Pty. Ltd. — South Africa	Subsidiary	100
ITW Asia (Pte.) Limited — Singapore	Subsidiary	100
ITW Ateco G.m.b.H. — Germany	Subsidiary	100
ITW Canada Inc. — Canada	Subsidiary	100
ITW Caribe, Inc. — Delaware	Subsidiary	100
ITW Deutsher Ltd. — New Zealand (2)	Subsidiary	100
ITW Espana S.A. — Spain (3)	Subsidiary	100
ITW Export Corporation — Delaware	Subsidiary	100
ITW Fastex Italia S.p.A. — Italy	Subsidiary	100
ITW de France S.A. — France	Subsidiary	100
ITW Hi-Cone Holdings Limited —Ireland	Subsidiary	100
ITW Hi-Cone Limited — Ireland (4)	Subsidiary	100
ITW do Brasil Participacoes Ltda. — Brazil	Subsidiary	100.1
ITW International Inc. — Delaware	Subsidiary	100
ITW Limited — England	Subsidiary	100
ITW Paktron Limited — Taiwan	Subsidiary	100
Packaging Leasing Systems Inc. — Delaware	Subsidiary	80

1982 continued

Company	Relationship	Percent Ownership
Philadelphia Resins Corporation — Pennsylvania (5)	Subsidiary	100
Philly Disc Corporation — Delaware (6)	Subsidiary	100
Plastiglide Limited — Canada (7)	Subsidiary	100
Plastiglide Manufacturing Corporation — Delaware	Subsidiary	100
UID Switches Inc. — Delaware	Subsidiary	100
Arrendadora Tlalnepantla. S.A. de C.V. — Mexico	Subsidiary-Affiliate	49
Envases Multipac. S.A. de C.V. — Mexico	Subsidiary-Affiliate	49
INCAP-Industria de Carregadores Plasticos S.A. — Brazil	Subsidiary-Affiliate	49
Inmobiliaria Cit. S.A. de C.V. — Mexico	Subsidiary-Affiliate	49
ITW Mapri Industria e Comercio Ltda. — Brazil	Subsidiary-Affiliate	49
Multipak de Venezuela C.A. — Venezuela	Subsidiary-Affiliate	48
Nifco Inc. — Japan	Subsidiary-Affiliate	32
Nihon Devcon Kabushiki Kaisha — Japan (8)	Subsidiary-Affiliate	49
Ricks Exploration Company — Oklahoma	Subsidiary-Affiliate	45

(1) Wholly owned subsidiary of Devcon Corporation.
(2) Wholly owned subsidiary of W. A. Deutsher Pty. Ltd.
(3) Wholly owned subsidiary of ITW International Inc.
(4) Wholly owned subsidiary of ITW Hi-Cone Holdings Limited.
(5) Wholly owned subsidiary of Devcon Holdings Inc.
(6) Wholly owned subsidiary of Philadelphia Resins Corporation.
(7) Wholly owned subsidiary of Plastiglide Manufacturing Corporation.
(8) 49% owned by Devcon Corporation.

1983

Company	Relationship	Percent Ownership
Bema Film Systems Inc. — Illinois	Subsidiary	100
Chicago Switch Inc. — Illinois	Subsidiary	100
Cumberland Leasing Co. — Illinois	Subsidiary	100
Devcon Corporation — Massachusetts	Subsidiary	100
Devcon Canada Limited — Canada (1)	Subsidiary	100
Devcon Export Corporation — Massachusetts (1)	Subsidiary	100
Devcon France — France (2)	Subsidiary	100
Devcon de Mexico, S.A. — Mexico (1)	Subsidiary	100
Devcon Holdings Inc. — Delaware (1)	Subsidiary	100
Devcon Limited — Ireland	Subsidiary	100
W. A. Deutsher Pty. Ltd. — Australia	Subsidiary	100
Heartland Components Inc. — Minnesota	Subsidiary	100
Illinois Tool Works South Africa Pty. Ltd. — South Africa	Subsidiary	100
Indiana Tool Company — Michigan (3)	Subsidiary	100
Irathane Systems Incorporated — Minnesota (1)	Subsidiary	100
Irathane International Ltd. — England (4)	Subsidiary	100
ITW Asia (Pte.) Limited — Singapore	Subsidiary	100
ITW Ateco G.m.b.H. — Germany	Subsidiary	100
ITW Canada Inc. — Canada	Subsidiary	100

1983 continued

Company	Relationship	Percent Ownership
ITW Deutsher Ltd.		
— New Zealand (5)	Subsidiary	100
ITW Espana S.A.		
— Spain (6)	Subsidiary	100
ITW Export Corporation		
— Delaware	Subsidiary	100
ITW Fastex Italia S.p.A.		
— Italy	Subsidiary	100
ITW de France S.A.		
— France	Subsidiary	100
ITW Hi-Cone Holdings Limited		
— Ireland	Subsidiary	100
ITW Hi-Cone Limited		
— Ireland (7)	Subsidiary	100
ITW do Brasil Participacoes Ltda.		
— Brazil	Subsidiary	100
ITW International Inc.		
— Delaware	Subsidiary	100
ITW Limited — England	Subsidiary	100
ITW Paktron Limited		
— Taiwan	Subsidiary	100
Lancaster Products Inc.		
— Wisconsin	Subsidiary	100
Meritex Plastic Industries, Inc.		
— Texas	Subsidiary	100
Meritex (Penang) Sdn. Bhd.		
— Malaysia (8)	Subsidiary	100
Packaging Leasing Systems Inc.		
— Delaware	Subsidiary	80
Philadelphia Resins Corporation		
— Pennsylvania (9)	Subsidiary	100
Philly Disc Corporation		
— Delaware (10)	Subsidiary	100
Plastiglide Limited		
— Canada (11)	Subsidiary	100

1983 continued

Company	Relationship	Percent Ownership
Plastiglide Manufacturing Corporation — Delaware	Subsidiary	100
Southern Gage Company — Tennessee (3)	Subsidiary	100
Thielex Plastics Corporation — New Jersey	Subsidiary	100
UID Switches Inc. — Delaware	Subsidiary	100
N. A. Woodworth Company — Michigan	Subsidiary	100
N. A. Woodworth Export Company — Michigan (12)	Subsidiary	100
N. A. Woodworth International Company — Michigan (3)	Subsidiary	100
Envases Multipac. S.A. de C.V. — Mexico	Subsidiary-Affiliate	49
INCAP-Industria de Carregadores Plasticos S.A. — Brazil	Subsidiary-Affiliate	49
Inmobiliaria Cit. S.A. de C.V. — Mexico	Subsidiary-Affiliate	49
ITW Mapri Industria e Comercio Ltda. — Brazil	Subsidiary-Affiliate	49
Multipak de Venezuela C.A. — Venezuela	Subsidiary-Affiliate	48
Nifco Inc. — Japan	Subsidiary-Affilite	24
Nif-Cone Leasing Ltd. — Hong Kong (13)	Subsidiary-Affiliate	40
Nihon Devcon Kabushiki Kaisha — Japan (14)	Subsidiary-Affiliate	49

(1) Wholly owned subsidiary of Devcon Corporation.
(2) 99.9% owned by Devcon Corporation, .1% by Illinois Tool Works Inc.
(3) Wholly owned subsidiary of N. A. Woodworth Company.
(4) Wholly owned subsidiary of Irathane Systems Incorporated.
(5) Wholly owned subsidiary of W. A. Deutsher Pty. Ltd.

(6) Wholly owned subsidiary of ITW International Inc.
(7) Wholly owned subsidiary of ITW Hi-Cone Holdings Limited.
(8) Wholly owned subsidiary of Meritex Plastics Industries, Inc.
(9) Wholly owned subsidiary of Devcon Holdings Inc.
(10) Wholly owned subsidiary of Philadelphia Resins Corporation.
(11) Wholly owned subsidiary of Plastiglide Manufacturing Corporation.
(12) Wholly owned subsidiary of N. A. Woodworth International Company.
(13) 40% owned by Illinois Tool Works Inc., 60% owned by Nifco Inc.
(14) 49% owned by Devcon Corporation.

APPENDIX F

ILLINOIS TOOL WORKS INC.
8501 West Higgins Road
Chicago, Illinois 60631
Telephone 312/893-3040
SILAS S. CATHCART, Chairman

October 17, 1984

Mr. Toshiaki Ogasawara, President
NIFCO Inc.
World Trade Center Bldg.
4-1, Hamamatsu-cho, 2-chome
Minato-ku, Tokyo 105, Japan

Dear Tosh:

I apologize for the delay in writing you following our phone conversation but we have been quite busy on a number of things.

As you know by past experience, it is very difficult for the U.S. based Board members of Nifco to attend with frequency your board meetings. Consequently, it is appropriate that they not stand for re-election at your annual meeting, and we hereby notify you that that is their decision. If you would like a formal notice in this regard perhaps you will forward one that is appropriate in the Japanese form, otherwise you can use this letter for that purpose.

Even though ITW will not be officially represented on the Board we would hope and expect that you would keep us informed as if we did have Board representation in view of our sizeable investment. In this regard I have in mind such matters as:

1. Major management changes

2. Major capital investments or sale of assets
3. Mergers or acquisitions
4. Stock issues
5. Significant borrowings or other financings
6. Contemplated programs of geographic expansion
7. Major new product programs that are likely to require sizeable capital expenditures or influence the course and results of the business significantly
8. Contemplated changes in stock holdings of major stockholders
9. Any other issues that may possibly affect the ITW NIFCO relationship either in product technology or financial areas.

You have always been very good in informing us in advance of any issues such as the above, so I assume that this will not affect any change in pattern or relationship or be burdensome. The purpose in listing the types of things that are enumerated above is merely to reflect on the types of matters that normally one would be involved in as a Board member but would not necessary get involved in as a major stockholder unless there were some understanding to that effect.

I hope that the above is satisfactory and if you have any questions or additions or deletions you will let us know.

Arthur Wright informs me that he is still trying to find the means for disposal of your Nihon Devcon stock and that this matter is far from forgotten.

I am sorry for the delay in responding to your request but hope that this letter is satisfactory and accomplishes the purpose that you had in mind.

Best wishes and hope to see you soon.

/s/ Silas Cathcart

cc: John D. Nichols, H. Richard Crowther, David B. Smith